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STRATEGIES FOR IMPROVING THE EFFICIENCY OF TRADE FLOWS AND STRENGTHENING THE BUSINESS CLIMATE IN THE CAFTA COUNTRIES

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Strategies for Improving the Efficiency of Trade Flows and Strengthening the Business Climate in the CAFTA Countries

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Contents

DISCLAMER

The author's views expressed in this publication do not necessarily reflect the views of the United States Agency for International Development or the United States Government.

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This report is the culmination of work carried out by teams of experts in each of the Central American CAFTA member countries. Missions to each of the countries were carried out throughout 2004 and resulted in a *Trade and Commercial Law Assessment* report for each nation, and are available at www.bizlawreform.com. The regional synthesis of these individual country reports contained in this volume was completed by Paul Fekete, Louise Williams, Andrew Mayock, and James Newton. In addition, through their work on each of country assessments, the members of the country assessment teams (listed in Appendix B) contributed significantly to this regional report. Mark Belcher and Emad Tinawi of Booz Allen Hamilton also provided significant assistance.

The assessment work was greatly facilitated by officials from USAID in the United States as well as in the region—both from the individual missions in El Salvador, Honduras, and Nicaragua, and, in particular, the Central American regional mission located in Guatemala. In addition, the U.S. Embassy in Costa Rica provided assistance. Finally, the process was made possible by the Trade Capacity Building representatives from each of the countries, as well as the numerous individuals who were interviewed and otherwise provided assistance from each of the five countries.

Executive Summary

This report synthesizes the findings of five country assessments that examine the existing legal and institutional environment for trade and business in five Central American nations—Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua. These assessments were commissioned and funded by the United States Agency for International Development (USAID), at the request of the Trade Capacity Building (TCB) Committees that were formed during negotiations.[1]

This report builds on the earlier country-specific analyses by exploring the regional implications of greater economic and political integration. This work is founded on the recognition that in an increasingly interconnected world, a country's unique historical, cultural, economic, and political circumstances tell only part of the story. Beyond this, there are the qualities or characteristics of a nation that define its "connectedness" to wider regional and global economies. The more seamlessly a nation is integrated into the global economy, the greater its prospects for sustained economic growth and social development.[2] The CAFTA provides an opportunity for streamlining and accelerating this process of closer regional economic and political integration. This report examines some of the most significant challenges and opportunities for achieving this end.

Many of the themes and findings contained in this report will be familiar even to the non-specialist. The challenges identified, of course, are not new. What is new is the CAFTA presents an opportunity to move the focus of the development dialogue beyond strictly national conceptions of how to respond to challenges toward a more broadly defined and integrated regional approach. For example, does it make sense to build a world-class motorway to the border only to have trucks queued for unreasonable periods to clear customs and then bump along narrow, congested roads for the rest of the journey to market? Should modernizing how security interests in moveable property are created and enforced be approached on a national basis, or harmonized across the region based on a single model?

The CAFTA creates a new context for examining many of the now very familiar challenges that the region faces from a perspective of mutual dependence. One of the main themes of this analysis is that the economies of Central America are too small to "go it alone" prosperously in the global economy. In terms of Gross Domestic Product (GDP), for example, the CAFTA countries[3] combined rank 46th in the world, just behind Norway and ahead of Finland. In terms of market size, CAFTA nations' combined population is the 34th largest in the world, just slightly ahead of Tanzania and behind Sudan.[4] This represents .05 percent of U.S. GDP and roughly 10 percent of the total U.S. population respectively. For Central America to achieve, sustain, and expand upon this level of scale, it will be necessary to not only think out of the box but to act outside of the box.

Skeptics—*and there are many*—will claim that a regional approach to "national" issues is either politically impractical or will require an intolerable assault on national sovereignty. The debate on this very question continues today in Europe—as it did at the founding of the United States. As the country reports that serve as the foundation for this discussion indicate, there are a great number of very specific and tangible reforms that should be initiated at the country level to improve the conditions for trade competitiveness and general business activity. Yet, if these reforms are addressed unilaterally, and in isolation, there is a risk of preserving, if not extending, the existing patchwork of disjointed laws, procedures, and institutional arrangements that impede the greater competitiveness of the region as a whole.

Increasing Efficiencies in Trade Flows

A key attribute of the global economy has been the sharp increase in the mobility of capital in its various forms—physical, human, intellectual, financial, cultural, and technological. Trans-border capital flows are also increasingly sensitive to even small variations in the local business environment. Nontariff barriers to trade exist throughout the CAFTA region and create significant inefficiencies in trade flows. These add substantial costs to doing business and act as a disincentive to both domestic and international investment. The most significant barriers are (1) inefficient and misaligned trade processes and procedures, (2) poor physical security, and (3) insufficient physical infrastructure. Moreover, a lack of technical capacity, clear programmatic priorities for reform, and a lack of resources significantly constrain reform in this area.

The CAFTA offers a unique opportunity to achieve increased policy coherence across the region through harmonization and cross-border linkages. This, tied with strategically significant upgrades in key trade infrastructure components financed in part by international investment, can deliver significant and measurable improvements in the region's trade competitiveness within a decade. The area where the greatest boost to competitiveness can be achieved with the lowest level of investment and the highest payoff in terms of reducing corruption is through modernization of customs and other trade-related functions. Improved risk management and uniform standards governing the health- and agricultural-related trade requirements stand out as key priority areas to be addressed. In each case, focusing on these issues through the lens of regionalism will allow for the most cost-efficient solutions, because there will be only one regional effort as opposed to five mostly redundant efforts.

The critical intersection of security and trade also remains an issue of vital importance for the entire region. Poor security is manifested in a number of ways, including, most notably, poor road security, widespread corruption, extensive smuggling, and weak criminal justice systems. Predictably, these conditions have made the region a significant haven for international criminal enterprises including those who engage in trafficking in various forms and money laundering. From the standpoint of trade competitiveness, poor security drives up the costs for producers, distributors, and consumers while driving investment elsewhere. As complex adaptive systems, criminal enterprises are highly resilient and adaptable. If County "A" launches a crackdown, the criminal enterprises can shift their operations to Country "B" overnight. This is yet another example of why mutual interdependence in the region is needed to exploit potential long-term benefits of the CAFTA.

With respect to trade infrastructure, the five CAFTA countries exhibit widely varying capacities and capabilities, all of which affect the cost-efficient movement of goods. Stripping away the policy, institutional capacity, and security considerations, the region is left with significant challenges to address concerning the trade infrastructure needed to be competitive in the global market. To date, focused efforts to improve infrastructure within some of the countries have demonstrated success. However, due largely to issues of physical geography and scale, the countries of the region are mutually interdependent in terms of roads, seaports, power, and information and communications technology infrastructure. This is an area where regional harmonization and coordination can deliver significant long-term benefits in terms of trade competitiveness.

Finally, budgetary and other resource constraints to supporting better trade facilitation in the region must be acknowledged. Difficult choices need to be made, and only a small portion of the requirements can be funded. Therefore, it is imperative for countries in the region to explore ways to combine and collaborate efforts to achieve mutual benefit, wherever it can be found in the region. This issue takes on special significance with respect to trade because trade- related institutions in Central America are a significant source of government revenues.

Strengthening the Business Climate

The assessments of the five CAFTA countries have highlighted certain very important insights with respect to the state of commercial law and institutions that affect businesses generally. Perhaps most important, creating and growing a new business in any of the five countries is difficult because of a maze of bureaucratic regulations and taxes. This is particularly true for small and micro-enterprises, because these conditions act as a particularly regressive form of taxation that crowd out small businesses. This situation has given impetus to a pervasive informal economy across the region. Outdated or inappropriate legal and institutional arrangements for a variety of critically important elements of a modern market economy act as major constraints to doing business, as well as to competitiveness. Weak and inefficient courts make contract enforcement highly uncertain. Market-clearing mechanisms such as bankruptcy and insolvency do not meet the needs of a modern economy. Laws intended to protect workers and consumers introduce market rigidities and do not effectively achieve their stated purpose. Weak corporate governance measures, inefficient systems for creating and securing property rights, and a variety of other critically important components of a modern legal system are either missing entirely, antiquated, or ineffective. Improvements in the commercial legal and institutional environment of each CAFTA country will allow business to grow, thrive and create conditions for the greater export potential of CAFTA to be tapped.

Harmonization in everything from the automation of courts, to litigation and enforcement procedures, to continuing legal education and anticorruption efforts for judges, would strengthen the position of all five countries as a worthwhile regional market for investment. The positive news is that perfectly serviceable models are readily available to use as a guide. In addition, there is ample room for experimentation and customization to meet region-specific conditions, needs, and priorities. For example, the persistent regionwide lack of access to credit—especially for small and micro-enterprises—could be significantly aided by regionwide adoption of the Organization of American States' Model Inter-American Law on Secured Transactions. The "cost" of doing this, whether from a financial or political standpoint, would be minimal, yet the likely long-term economic benefits would be both significant and enduring.

It must be acknowledged that whether one is in the realm of facilitating trade or strengthening the general environment for business, thinking and acting outside the box takes significant funding, without which even the best of intentions will fall short. Obviously, the ideas represented in this report carry, in many cases, significant costs. Although the report does address this issue at some levels, it cannot offer all solutions. What it does provide is a framework for a discussion of priorities so that benefits can be weighed against costs. One thing, however, seems certain: working for one coordinated regional solution, although perhaps harder to achieve in the short term, will in almost all cases be more efficient and provide more sustainable and long-term benefits than pursuing five, independent, national solutions. Accordingly, this report and the January 2005 workshop in Guatemala City for which it was prepared are intended to spark a discussion about how regional approaches to these or other reforms in the region could be prioritized to achieve the greatest success. In so doing, the CAFTA process can be harnessed to achieve the vision and consensus needed for bold but realistic and achievable regional efforts to bring down significant, yet entirely addressable, barriers to enhanced competitiveness, economic growth, and social development.

It should also be noted that there is a significant role that the international donor community can continue to play in facilitating and supporting CAFTA nations to embrace the promise of sustainable and equitable economic growth through greater regional harmonization and integration. For example, CAFTA implies the development of a regional institution for managing and resolving contract disputes and other commercial litigation, an idea for which a significant amount of interest was expressed during the five country assessments. Employing such a mechanism could free businesses from the flawed systems currently existent in CAFTA countries, and the international community may be the party best positioned to provide a forum to facilitate these ends. This is just one example among many highlighted in this report where making common cause across the region—among the countries themselves as well as the international community—makes sense.

On a closing note, with respect to the nearly ubiquitous challenge of corruption, the country assessments highlighted a pervasive lack of confidence in the integrity and effectiveness of trade systems and the commercial law environment throughout the region. Although it is difficult to measure, it is clear that corruption, within both commercial law and trade-related institutions, and in both the public and private sectors, adds friction to the process of CAFTA nations moving forward, individually or as a group. There is a strong case for creating and bolstering not only country-specific programs that target corruption but also a regionwide anticorruption initiative. A regional program would send a message to outsiders, especially those who are inclined to view Central America as a single market, that the challenge is one that is being taken seriously, and that each of the five countries is prepared to put aside national priorities to confront this most pernicious of economic, social, and regional challenges to development.

I. Introduction

The world today is far more interconnected than just a decade ago. Events that occur far beyond domestic borders, indeed, in other regions, affect nations at home in very real and tangible ways. This greater interconnectedness is not a choice, but a new operating reality. It is changing how nations and people live and interact with their neighbors and beyond. Even for the smallest highland village, the relative comfort of its traditional, insular existence is rapidly fading. Whether for good or ill or both, today the world is far more complex, far more dynamic, and far more challenging than previously known.

This new operating reality presents both opportunities and threats. Whether one is "for" or "against" globalization trivializes the question. The real issue is how to respond—individually and collectively—to this changed environment. More often than not, the choice is to keep on doing what has been done before. Logic dictates that this is the safest way, assuming that nothing on the path has changed since the prior journey.

The challenge for the CAFTA countries, currently Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua, is to achieve the maximum benefits under the CAFTA in terms of quality jobs and sustainable development and economic growth, while also seeking to ameliorate social, environmental, and cultural consequences, which often accompany freer trade in the region. How this is done is the heart of the matter. This report addresses those issues, in particular the problems with and ways to improve trade flows and the business climate, that are on that new path.

CAFTA negotiations began in January 2003. These negotiations took place in San Salvador, El Salvador; San Jose, Costa Rica; Guatemala City, Guatemala; Tegucigalpa, Honduras; Managua, Nicaragua; and in the United States, including in Houston, New Orleans, Cincinnati, and, finally, Washington DC. The five Central American countries already were joined in a free trade zone, making the negotiation of CAFTA a logical next step toward greater regional economic integration. During CAFTA negotiations, a committee was formed between the Trade Capacity Building (TCB) committee representatives from each of the Central American countries and the U.S. Government—through the United States Trade Representative (USTR), and the U.S. Agency for International Development (USAID). One of the main recommendations of the TCB committee was to identify specific reforms that if pursued would help CAFTA countries maximize the benefits of freer trade under the agreements. The committee identified trade facilitation and the regulatory environment for business as priority areas for analysis.

In response, the U.S. Government, through the auspices of USAID, commissioned a series of technical assessments and analyses in each of the five CAFTA signatory countries. The assessments were conducted by a multidisciplinary team of trade, legal, regional, and development experts between May 2004 and September 2004 in each of the CAFTA countries.[5] The subject matter coverage and analytical methodology of the assessments were consistent across the five countries. The principal outputs of the assessments included five country reports identifying and discussing country-specific findings and recommendations, and this regional report.

The country reports contain specific, concrete recommendations for reform in each of the five signatory countries. In the face of these many fixes, the main insight that arises from these analyses is that the countries of Central America should also cooperate on a scale and scope that is perhaps unimaginable today. That is, although domestic reforms are needed, those alone will not be enough, and serious cooperation is mandated.

This new path suggested by the data is daunting, yet in many respects, familiar. For example, the need to strengthen the ability of the courts to resolve commercial disputes in an efficient, transparent, and predictable manner is old news. With the greater economic integration and the freer flow of trade and investment across the region, however, the scope of the problems of dispute resolution will change as well, necessitating the new approach. Similarly, the long-held dream of a robust and thriving north-south corridor will remain simply that unless infrastructure investment, transit procedures, border security, criminal justice, and many other related activities are coordinated regionally, even if implemented locally.

This report, therefore, serves as a framework for a regional dialogue among key business, government, and civil society stakeholders from each of the five CAFTA countries, the United States, and other international and multilateral actors, including, for example, the Inter-American Development Bank (IADB), the World Bank, and the European Union. A significant portion of this dialogue will be to set priorities, because obviously none of these reforms are free and resources are scarce. It is the goal of this report to provide a new context—one that matches new realities—in which such choices can be made. The first significant dialogue in this new context will be held in Guatemala City, Guatemala, from January 18 to 20, 2005, when numerous professionals from throughout the region will gather to explore the implications of these findings, identify options for mutual collaboration, and set an agenda for moving forward that is specific, measurable, actionable, realistic, and timely. To facilitate this discussion, Section II of this report describes the connection between trade opportunities, economic growth, development, and greater regionalism. Section III explains the challenges facing Central American countries undergoing reform, and the importance of trade facilitation and commercial environment to CAFTA, and describes the major barriers in these two key areas. Section IV provides strategies for removing these barriers. Finally, the appendices provide the methodology for work leading to the preparation of this report and a Central American economic profile.

This report is intended to catalyze a process of broad domestic and regional economic reform. Some of the reforms herein are not *directly* related to international trade, yet it is undeniable that the status of trade facilitation and commercial law and institutions impact the ability of a business, and accordingly a nation, to grow. A failure to address these issues would only continue the numerous nonobvious costs already inherent in Central American business and put the region at a disadvantage as it proceeded down its new path toward what should be a lasting prosperity.

II. Development, Integration, and Economic Growth in Central America

With a record of inconsistent economic growth and approximately 60 percent of its population living in poverty, Central America faces significant development and economic challenges. To address these issues, a first step is for Central American nations to increase their economic productivity. Although necessary, however, freer trade alone is not sufficient to achieve sustainable growth. A commitment to other reforms is needed as well—not only in trade-related and commercial law areas but also in such areas as macroeconomic policy and education. Trade-related and commercial law reforms, however, will complement and in some cases lay a groundwork for those further reforms. In either case, quite simply, the best way to harness Central America's resources is to create a more unified and integrated region of more than 35 million inhabitants, which bolsters both inter- and intra-regional trade, as well as recognizes and practices true democratic governance.

Trade and Development

The theory of comparative advantage states that liberal trade—that is, international commerce that takes place with few or no trade barriers—yields the greatest economic benefit through the ability of countries to differentiate and specialize in their productive activities. The open exchange of goods and services creates more wealth than would be created if economies were less specialized, and accordingly helps nations cut costs of living, raise incomes, and stimulate economic growth. In short, it helps them to develop.[6] Although some critics and detractors maintain that the theory, in general, and free trade agreements, more specifically, fail to equally distribute benefits and profits and thus lead to societal inequalities, the CAFTA nations have implicitly shown their agreement with this proposition in signing the free trade agreement and welcoming other related assistance such as the development of this report and associated activities.

While there may be evidence that particular individuals and groups within society are often affected differently by trade liberalization—and the lessons of trade liberalization suggest that, in the short-term, there are winners and losers—quite simply, in the long-term, countries accrue broad-based benefits from trade. Moreover, there is a positive correlation between trade and poverty reduction, a key issue in Central America where significant portions of the population live well below the poverty line.[7]

Trade Plus

Recent experience has shown, however, that freer trade alone is not a means to an end. A recent study by the World Bank discussing the effects of 10 years of the North American Free Trade Agreements (NAFTA) concluded that for Mexico, "free trade definitely brought new economic opportunities, but ….that free trade alone is not enough without significant policy and institutional reforms."[8] The study highlights that economic development is not only a product of freer trade, but that success is dependent also upon good governance, transparency, and accountability, as well as the rule of law. While at times slow to occur, such reforms and policies have begun to take hold in Mexico.

Deeper Integration

For decades, the Central American nations have struggled with the impediments that all small nations encounter. They have found it difficult to reap the benefits of specialization and the economies of scale that would come from such production. With individual populations ranging from approximately 4 million in Costa Rica to almost 14 million in Guatemala, their domestic markets are too small to generate the level of demand that would fuel significant growth. For such demand to develop, these countries need to link with each other and the international trade system more actively. Moreover, with expanding globalization, Central America faces the competitive pressures from other countries and regions that continue to increase their trade capacities, such as China, Brazil, and India.

Regionalism Then and Now

Throughout the 19th and 20th centuries, Central American nations went through various efforts at regionalism; few, if any, have achieved lasting success. For example, Central America was the first region to create an international judicial system, with the creation of the Central American Court of Justice in 1907. This body and its successors, however, have remained in the background. Other regional organizations, such as the Organization of Central American States of 1951, the Central American Common Market of 1961, the Central American Parliament of 1991, and Central American Integration System were efforts to realize political, juridical, and economic regionalism. Most recently, Central American Presidents approved an ambitious plan for deeper integration: the Plan of Action for Central American Economic Integration. The plan calls for the progressive implementation of the customs union, and all five of the CAFTA countries are now parties. Obstacles such as high trade transaction costs and limited political will, however, have made completing the customs union, and accordingly achieving greater regionalism, a challenge.

Despite prior halting efforts at regionalism, trade agreements are a logical step toward achieving the goal of a true common market in the region and in the larger international trade arena. Although the CAFTA does not call for a common external tariff—and in fact recognizes different product sensitivities as separate market access negotiations were held with each of the CAFTA members—the process of negotiating the agreement with the United States and among the members itself has lead to closer cooperation and coordination among the CAFTA countries.

Benefits of Greater Regional Integration

The opportunities and benefits of greater regional integration through regional trade agreements (RTAs) are numerous and real. First, RTAs enhance competitiveness by lowering input costs, which further integrates economies regionally and internationally and increases competition from imports. This, in turn, drives productivity growth. Second, real regional integration through RTAs allows otherwise small nations to create and take advantage of scale economies and leads to joint programs to improve border crossings or motivate liberalization in services. Third, as the World Bank has found, regional trade agreements can help spur and strengthen broader reforms in domestic policy.[9] Fourth, as with the NAFTA agreement with Mexico, and other "north-south" trade agreements, an improved trade relationship between the United States and Central America is viewed as a means toward greater political and economic stability, investment and growth in the region, and as a way of mitigating some of the migration pressures wrought by the poverty of the region.[10]

With the rise of China and other major players in the world trade system, Central American countries must act together to maintain the progress they have achieved over the past two decades. For example, the textile and apparel sector has been responsible for most of the growth of Central American manufactured goods and manufacturing jobs created since the 1980s. The January 2005 expiration of the Agreement on Textiles and Clothing, however, increased the competitiveness of China and other major textile producing countries with Central America's major trading partner, the United States. The CAFTA countries' ability to adapt to this change through lower trade transaction costs and a more supportive commercial environment will directly impact their ability to maintain manufacturing and jobs in this area, and accordingly impact their ability to bring about economic growth. In short, the countries of Central America will be better able to meet the economic challenges of the future as one larger economy, rather than five smaller ones.

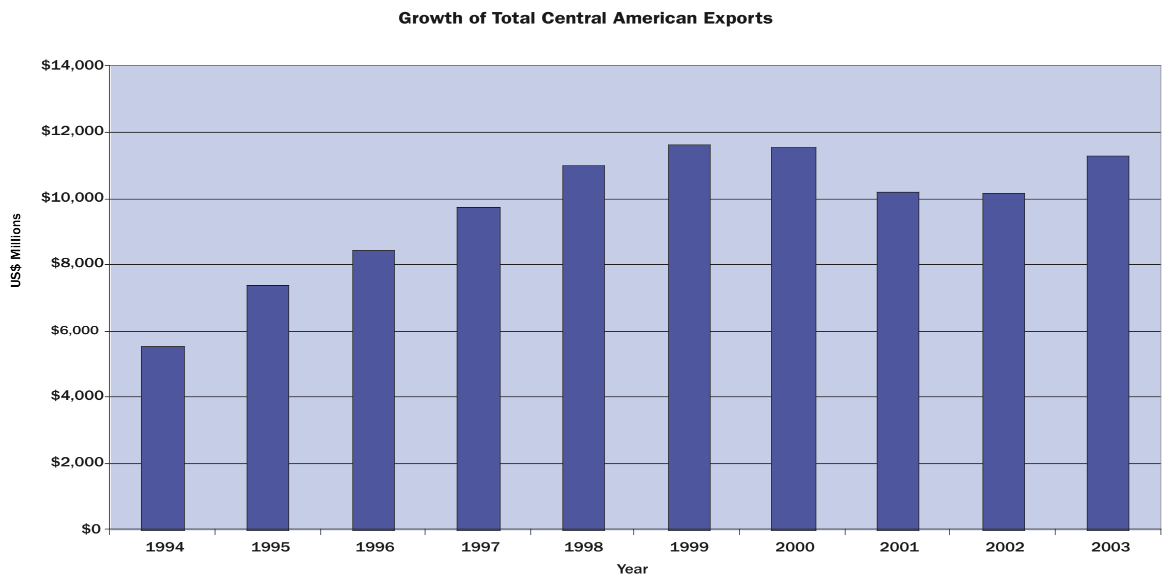
Prospects for Economic Growth

Anticipation of the economic benefits and growing importance of regional and free trade are a driving force for countries to anticipate in the CAFTA. The fact that Central America and the United States already enjoy a strong and growing trade partnership, taken in the context of the successes of other U.S. free trade agreements, suggests that trade growth among CAFTA members may be noteworthy.

Bolstering Currently Expanding Trade

Recently, Central America's growing trading position (Figure II-1) has been driven by the Caribbean Basin Economic Recovery Act (CBERA) and Caribbean

Figure II-1. Central America's Growing Trade Position with the United States

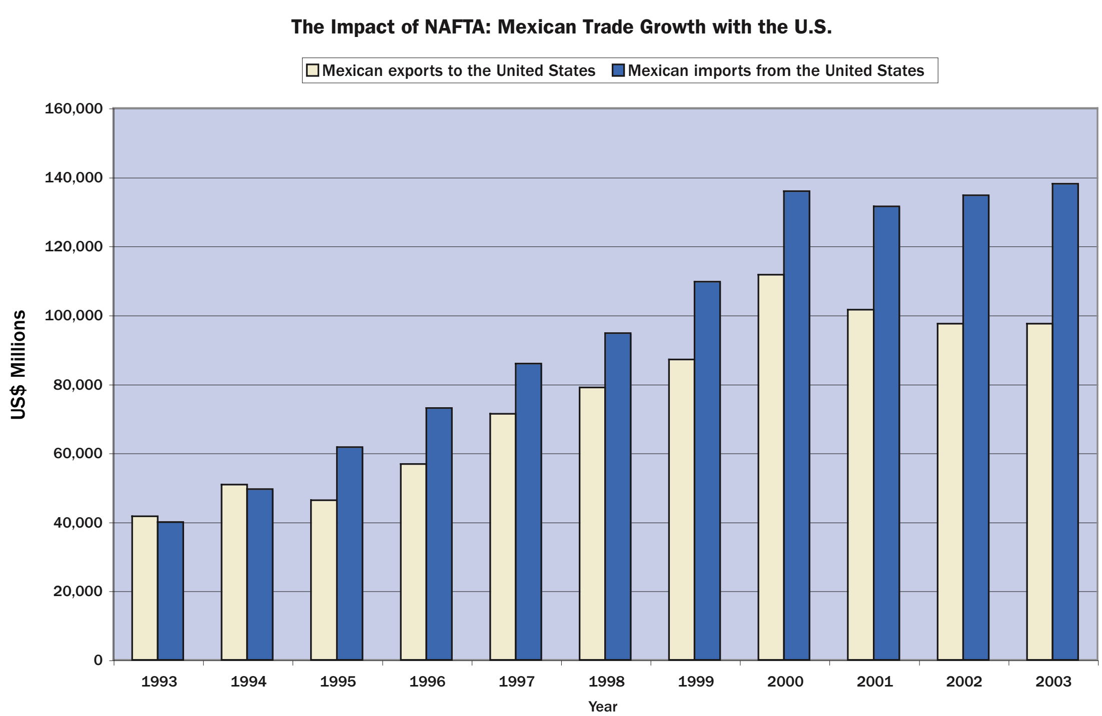


Source: Secretaría de Integración Económica Centroamericana

Basin Initiative (CBI). Through CBERA and CBI, Central American economies have been expanding and transforming through the development of light manufacturing, especially in the apparel sector.

As prior regional and bilateral agreements containing similar provisions demonstrate, such measures carry with them significant potential economic benefits. Moreover, a regional agreement, because it is undertaken by a smaller group of nations, covers issues and requires commitments that are more significant than the "lowest common denominator" approach often characteristic of multilateral

Figure II-2. Mexican Trade With the United States



Source: U.S. Department ofCommerce

agreements, bolstering the region's trading position. These facts, coupled with the well-documented importance of geographic proximity to the United States, which gives the region a competitive advantage, offer the region opportunities for greater prosperity.

Trade Growth under U.S. Free Trade Agreements: NAFTA

The greater promise of future economic benefits from regional trade agreements is reflected in Mexico's experience with NAFTA.[11] NAFTA has resulted in a serious expansion of trade among its three partners as the total volume of trade among the three NAFTA partners expanded from $289.3 billion in 1993 to $623.1 billion in 2003. Focusing on the CAFTA countries' neighbor, Mexico, during this period, Mexican exports to the United States, for example, reached more than $138 billion (Figure II-2). In turn, U.S. exports to Mexico grew from $46.5 billion to over $100 billion. Moreover, each country experienced growth of exports not only to their NAFTA partners but also with the rest of the world; estimates show that Mexico's global exports would have been between 25 and 30 percent lower if it had not joined NAFTA.[12] Further, Mexico's resilience in its recovery from the 1995 Tequila Crisis was in large part due to linkages created by NAFTA. All this has occurred, however, despite findings by the World Bank that key factors —such as the quality of institutions, a lack of innovation, and deficiencies in infrastructure—have constrained Mexico's development, meaning, in short, that Mexico has not reaped the full possible benefits of NAFTA.

U.S.-Jordan Free Trade Agreement

The U.S.-Jordanian Free Trade Agreement, signed in 2000, also points to positive results. Between 2000 and 2003, Jordanian exports to the United States increased more than eightfold, from $73 million to $673 million with a 60 percent increase between just the years 2002–2003. Similarly, U.S. exports to Jordan in the same period increased from $312 million to $493 million, an increase of approximately 58 percent.[13] While any meaningful assessment of this free trade agreement is exceptionally premature, these numbers provide some encouraging data.

III. The Role of Trade Facilitation and the Commercial Environment in the CAFTA Countries

As a result, therefore, both the history of other trade agreements, and Central America's current trade position, demonstrate that CAFTA has the potential for significant positive economic impact. As other free trade agreements have shown, however, to achieve the full potential of this opportunity, reforms must be made in numerous sectors. CAFTA member countries now face numerous economic policy challenges with the conclusion and forthcoming implementation of CAFTA, the ongoing integration process of the Central American Common Market (CACM), and other multilateral, regional, and bilateral efforts. Among these challenges, two prerequisites for seizing benefits are the primary subjects of this report:

1. A secure and efficient movement of trade through improved trade facilitation
2. A supportive commercial environment through legal and regulatory reform.

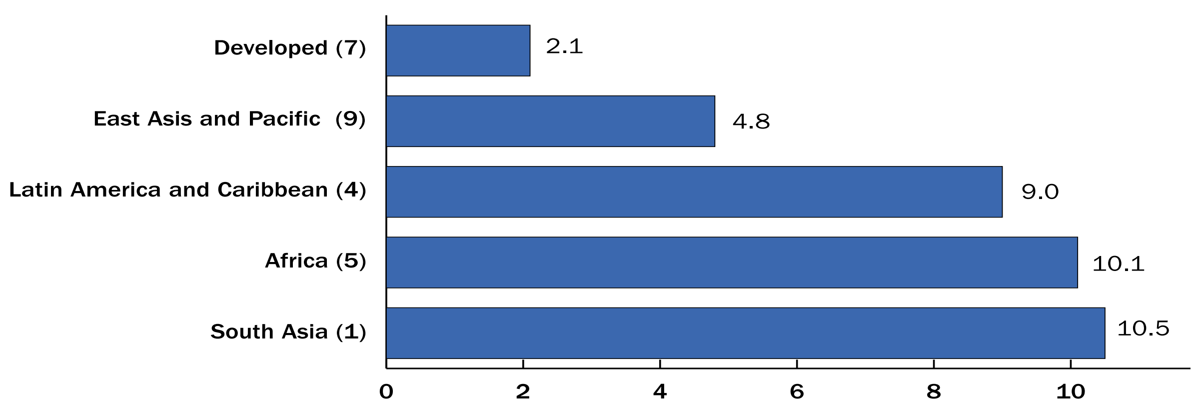
Without a favorable business environment, domestic entrepreneurs and interested foreign investors will be hesitant to seek new opportunities in the region. Without a more efficient and secure trading system, these entrepreneurs and investors cannot efficiently and securely move their goods and services. Improvements in these areas are key to unlocking CAFTA's potential and achieving the increased economic growth, development, and productivity.

Trade Facilitation: Securing and Streamlining Movement of Trade

Although the removal of tariffs and quotas provides market access, tariff and quota changes are only one component of the overall trade costs. In fact, these trade tariff and quota measures are often relatively minor costs. With the CAFTA region, it is more often logistical, institutional, and regulatory barriers that impose significant costs on trade and make their products and services less competitive as well as their countries less attractive places for investment. The impeded ability to physically move goods to export markets across frontiers raises numerous issues including those related to: transportation policy and infrastructure; import and export procedures (e.g., customs or licensing procedures); transport formalities; and payments, insurance, and other financial requirements. From the private sector's point of view, companies that seek to enter the global marketplace need to be able to acquire information regarding other countries' importing and exporting regulations and how customs procedures are handled—raising issues of procedural and regulatory transparency. Cutting such varied instances of red tape are examples of facilitating trade, which will ensure ongoing regional success.

The tax equivalent of trade costs imposed by poor trade facilitation can be enormous. According to some estimates, these taxing trade costs can range

Figure III-1. Average Days Required for Customs Clearance for Sea Cargo



Source: International Exhibition Logistics Associates from 30 to 105 percent of import value, depending on the sector.[14] These costs can be significantly reduced through streamlined regulation, improved trade operations, and better infrastructure, which will make products of the region more competitive. In fact, the potential economic benefits of trade facilitation are high, with one recent 75-country study finding that improved trade facilitation could increase trade flows by $377 billion, with the benefits falling disproportionately on exports.[15]

Trade in the post-September 11, 2001, era also poses new challenges to all trading countries. This burdens developing countries particularly because of the significant costs of meeting new security standards. On the other hand, security improvements can raise investor confidence, add stability to the global economy, and streamline the trade process. Security-related automation, for example, can increase transparency and decrease delays, thereby reducing cost. The CAFTA countries must adjust to these new requirements and, where possible, leverage those security changes that ease and assure trade flows.

By eliminating the unwarranted and onerous constraints embodied in laws, regulations, procedures, and infrastructure, the CAFTA region can capture greater savings and efficiencies. Significant savings can accrue to the CAFTA region with improved trade facilitation. In turn, these savings will spur more exports by making Central American exporters more competitive and lead to lower prices for Central American consumers.

In addition, lower trade costs will enhance Central America's overall attractiveness as an investment opportunity. Large investors will look at the area as one entity and require security of transit throughout the region and a facilitative, standardized, and seamless process in crossing from one country to the next. In addition, economies of scale in such areas as transport improvements only make economic sense when considered on a regional basis. Seizing the full potential of this opportunity is hardly guaranteed, however, and the full potential of the agreement will only be realized if the member states lessen the friction caused by trade facilitation costs.

Commercial, Legal, and Institutional Reform: Creating a More Supportive Business Climate

In addition to securing and streamlining trade, another prerequisite for expanded trade and economic development is a sound domestic commercial legal and institutional framework. The commercial environment is critical to both the success of CAFTA and to the greater issue of economic and social development. A conducive business environment supports productive private investment—both domestic and international. It is productive private investment that is the foundation for economic growth through the creation of opportunities and jobs. A more conducive business environment expands the variety of goods and services and lowers their costs. Consumers and producers benefit. Further, a good business climate supports and strengthens the tax base, which is essential to fund a variety of economic and social goals. The basic conditions of a quality business climate directly improve the quality of life of all people. These include such components as rule of law, efficient financial services, and respect for property rights.

Without a favorable business environment, domestic entrepreneurs and interested foreign investors cannot seize new opportunities. As the assessment teams found, the business climate directly affects the decisions of entrepreneurs at all levels, such as: the decision of an international company to locate its activities; the decision of farmers in planting their next crop; or the decision of a small business owner to register his or her company or to remain in the informal, or "gray", market.

The extensive analysis in this report pertaining to both trade facilitation and commercial law and institutions identifies barriers to doing business in the region, both for domestic enterprises and for foreign investors. Thereafter, specific recommendations propose a variety of ways in which the region as a whole may dismantle those barriers and collectively embrace the opportunities for economic development.

Trade Facilitation: High Trade Costs Holding the Region Back

The Trade and Commercial Law Assessments performed in each of the five countries identified numerous nontariff-related barriers to trade, which affect stakeholders, public and private, at all levels, and which have national and regional affects. This section, therefore, focuses on the highest priority issues whereby significant benefits from improved trade facilitation can accrue. The primary such barriers are (1) the variable quality of trade processes and procedures, (2) the challenging security environment, (3) inconsistent infrastructure, and (4) constrained budgets. By addressing these key barriers, CAFTA countries can move forward in achieving the agreement's opportunity. The recommendations section of this report addresses actions the region can take to overcome these barriers.

Slowing Down the System and Adding on the Costs: Variable Processes and Procedures

One of the most significant barriers to improved trade flows is the variability and poor quality of processes and procedures of trade-related institutions affecting goods and services crossing Central American borders, including agencies handling customs, security, agriculture, and health. For the region to thrive economically, it is imperative to have secure, yet efficient, passage of goods and services. CAFTA members have made progress toward this goal in numerous ways and the foundation for real reform is in place. However, barriers large and small still present themselves to those doing business intra- and extra-regionally. Primarily, the trader is forced to deal with different procedures at different borders, thus delaying goods, raising costs, and keeping the trader from market.

Burdensome Export Requirements

Burdensome requirements needlessly undermine the essential engine for growth: export. CAFTA members should be doing everything possible to assist exporters in getting their goods and services to market. In too many countries in the region, however, exporters encounter bureaucracies that slow them down and add costs. These costs include, for example, multiple visits to various agencies, even though every export requirement can and should be electronically administered by a single source. Common to most countries is the failure to re-engineer the paper process before automating, which remains one of the most significant export impediments. Trying to automate outdated, cumbersome processes is much more difficult than automating reformed, streamlined processes. While administering exports will remain within national jurisdiction, there is no reason why there cannot be movement toward harmonization, with regional standards eventually being agreed upon and implemented.

Poor Free Zone Administration

The uneven and sometimes inefficient administrative processes in free zones, which are key economic tools, also needlessly impair exports. Free zones have led to significant economic development throughout the region, and they provide an opportunity for the region to develop further from their agriculturally based economies. Yet, for example, several free zones in the region are not linked to the customs automated operating system, thereby adding costs. Another example is a Nicaraguan regulation that requires a customs guard, at the cost of the user, to accompany all movements of goods traveling among the free zones. This regulation affects many shipments because goods are commonly processed and transferred among the zones. Such inefficient trade administration in the free zones often hinders, instead of supports, growth.

Underdeveloped Risk Management

Underdeveloped risk-management systems are found throughout the region. This situation leads, in some countries, to high numbers of nonproductive, costly, and time-consuming physical examinations of traded goods, reaching as high as 40 percent of their cost. Moreover, physical examinations do not provide adequate results because of inadequate examination techniques and equipment. This barrier has far-reaching implications: not only does it result in added delays and costs, it also hinders the development of a compliance relationship with traders—an essential dynamic needed throughout the region to facilitate trade.

Low Levels of Specialization

Throughout Central America, customs capacity in specialized functions, including commodity valuation, risk management, and post-entry audit, is inadequate. Currently, the trade community is seen as noncompliant, and undervaluation poses a serious risk. Customs agencies, however, cannot combat this problem without better tools through further development of risk-management and post-audit functions. When a specialized group is developed, in commodity areas, for example, its members become industry experts who know classifications, value, and trends within their areas of expertise and are an invaluable resource for detection of fraud, development of risk-assessment strategies, and the formation of working relationship with trade to development information. In order for CAFTA countries to establish and maintain modern customs organizations—either independently or as a region, where the focus is on balanced trade facilitation and control—creating capacity in these specialized functions is essential.

Uneven Automation

Although efforts to automate trade functions are improving, automation is still a significant problem throughout the region, and such technology gaps present a major obstacle to regional integration and the customs union. On a systemic level, automation platforms vary from country to country: Costa Rica and Guatemala have proprietary systems, while El Salvador, Honduras, and Nicaragua have versions of United Nation's Conference on Trade and Development's (UNCTAD) Automated System for Customs Data (ASYCUDA). Some of these systems are relatively advanced. For example, El Salvador customs has a centralized database at its main customs' office with satellite communications links to posts throughout the country with developed modules for more efficient transit and vehicle control. This system handles approximately 1500 transactions daily with 24/7 system coverage. At the other end of the spectrum, Nicaragua's main offices have no connection to border posts, and its data rests on a single server with no backup.

Functionally, few of the platforms have sufficient ability to conduct modern customs functions, such as a sophisticated risk-management process.[16] For example, at some border sites staff manually input bill data into the automated system after verifying such data with the declaration. Because there is no regional system and limited automation, this process may be repeated at various borders. Thus, for example, a shipment heading from Costa Rica to Guatemala by truck is unable to move freely across the borders of Honduras and El Salvador even after checking into the system at the beginning of its regional journey at the Costa Rica-Nicaragua border. When the shipment reaches the Nicaragua-Honduras border, Nicaraguan customs inputs it into their transit system, a Honduran customs officer stationed there inputs it into his country's transit system, and a Guatemalan customs officer, also stationed there, inputs it into his transit system. Historically, systems have lacked automation and been unable to communicate efficiently, if they have been able to at all, leading to inconsistent processing between and within countries and repetition of relatively inefficient tasks. Improvements are being made, however, led by the Secretaría de Integración Económica Centroamericana (SIECA).

Nevertheless, as a result of customs automated processing systems within the region not being fully integrated, there is still too much reliance, for example, on documents, which impedes transit operations. Therefore, transit movements, which should be unhindered once they reach the external border of the union, must be re-input into each national system on both arrival and departure. This process should be reviewed and streamlined. There is a clear need for an integrated Central American transit system to eliminate individual national tracking of goods.

Onerous Agriculture and Health Requirements

Critical noncustoms regulations, such as sanitary and phytosanitary (SPS) regulations, place yet another obstacle in the way of traders. This is a major factor in improving trade because agricultural, food, and pharmaceutical products are a significant percentage of the goods traded in the region. The current system, however, adds significant cost and delays to imported food products and still more to pharmaceuticals and cosmetics. Moreover, because of the lengthy delays and high costs, many circumvent the system through smuggling and false declarations; some industry representatives state that up to 50 percent of food items at the retail level are unregulated. This situation puts the legitimate trader at a severe competitive disadvantage and can force the smaller importer out of business or into the black market.

In this area, a number of issues arise: (1) SPS processes are not well defined and invite misinterpretation and favoritism; (2) systems for communicating procedural changes to the trade community are poor or nonexistent; and (3) small economies, like CAFTA members, face serious difficulties meeting the constantly increasing and rigorous international food safety requirements for export. As a result, importers face delays entering CAFTA countries, and CAFTA export products are denied access to the global market for extended periods while their regulatory agencies and growers attempt to implement and certify that production meets relevant standards.

Another example is the lack of blanket import permits to allow for repeat, customary imports, as most countries require a permit for every incoming shipment. When combined with automation shortcomings, such as permits for noncustoms trade processes that are manually issued only by the relevant agencies at headquarters' offices with no direct interface with the traders or customs agencies, traders face added burdens. For example, in El Salvador, agriculture-related permits can only be obtained at the agriculture headquarters office in San Salvador through the submission of hand-carried paper documents.

Harmonization of Central American SPS laws and requirements should be implemented. Although the laws among the five Central American countries are generally standardized, the procedures and requirements regarding implementation vary significantly. Shippers to the region list this as a major priority. Efforts to standardize procedures have been ongoing for many years, unfortunately with little success. The many reasons for this include: (1) the limited number of qualified SPS specialists within each country; (2) the lack of political will to accomplish the task because of the desire to use SPS issues to protect domestic producers; and (3) the lack of continuity in personnel and policy at the executive level to pursue this long term goal in a consistent manner.

Delayed Express Shipments

Current procedures pertaining to express shipments present major problems to traders. Expedited direct delivery procedures allow for same day processing of some packages. However, delays are persistent because of: (1) a lack of standardization and uniformity in customs processing because there are no implementing regulations; (2) customs' operating systems and companies' electronic manifest files are not linked, which leads to the use of hard copies of manifests presented in advance of, or on, arrival; and (3) excessive numbers of administrative penalties for unintentional minor errors or admissions. Without simplification and compilation of declarations, as well as the use of an electronic interface shippers will continue to face delays.

Inadequate Trade Administration

Trade-related agencies lack the necessary administrative authorities and uniform practices of modern trade administration. For example, there is no binding advanced ruling process that covers essential areas such as classification, value, origin, quota, drawback, and other customs processes. The ruling processes that do exist vary from country to country, are very limited in scope, and receive limited use. Without an advanced ruling procedure, trade-related agencies lack a modern administrative tool that provides transparency and predictability to trading systems. These types of barriers exist in other areas as well, including rules of origin, quota administration, and dispute settlement. The regional lack of capacity for handling these issues detrimentally affects the system and is indicative of a larger issue in trade administration: the absence of harmonized trade agreements among the Central American countries. Because some, but not all of the five CAFTA countries, have free trade agreements with Canada, Chile, the Dominican Republic, Panama, and Taiwan, the overlapping agreements lack uniformity in tariff treatments and rules of origin which further complicates the regional integration process.

As can be seen from the breadth of challenges that exist with respect to trade processes and procedures, much must occur to ensure that both the CAFTA countries and the region as a whole are able to reach their potential.

Adding the Cost of Insecurity to Trade: Crime and Instability

The intersection of security and trade remains a critical issue for the region. Poor security is manifested in a number of ways, including, most notably, poor road security, corruption, smuggling, and weak criminal judicial systems, each of which impedes trade facilitation and hinders growth. An inadequate security environment drives up the costs for traders, as they must provide additional private security to their production facilities and transportation movements. Insecurity drags down the region's attractiveness for foreign investors. Although the exact type of security issue varies somewhat among CAFTA countries, the costs of inadequate security in one country are felt throughout the regional trade system. Security is, therefore, a regional problem that should be addressed on a regional basis.

Poor Road Security

A powerful example of the costs of the insufficient security environment in the region is road security, which poses a major problem in a number of countries. In Honduras, for example, approximately 80 percent of cargo moves with additional security measures. These include armed guards, at a cost of $45 to $50 per load, plus continual monitoring of each shipment in transit, at a cost of $10 to $20 per movement. These fees are sometimes incorporated into the general tariff of the carrier. In countries such as Honduras and Guatemala, cargo does not move over the road after 6 p.m. As a result of some private and public initiatives, security is improving, but at significant cost to the trader and significant opportunity cost to the region.

Blind Spots and Smuggling

Protection of borders, particularly the blind spots between land-border crossings, is extremely challenging in Central America and leads to high flows of contraband goods, people, and money.

Indications are that as much as 80 percent of imported merchandise is either undeclared or falsely declared due, in part, to weak border protection. Smuggled commodities include fuel, dairy products, coffee, and livestock. Such smuggling leads to undervaluation of goods, which then undercuts legitimate traders and keeps precious tax dollars from public coffers.

Weak Prosecution

Criminal prosecutions and judicial systems in general are problematic throughout Central America. Despite the recognition by all parties of smuggling and false declarations as major threats to the region's economy, few trade-related violations are pursued for criminal action because of low capacity and low integrity in many of the criminal law systems of the region. Discovering transgressions and effective punitive actions that would act as a deterrent are lacking. As a result, customs agencies claim they cannot rely on the courts to administer fair justice, and thus settle such cases administratively. Moreover, administrative penalties and settlement of the case with unofficial payments result in a loss of revenue and creates an environment that encourages smugglers to expand their activities.

Straining from a Weakened Core: The Burden of Inconsistent Infrastructure

The five CAFTA countries exhibit widely varying physical trade infrastructure components necessary for the cost-efficient movement of goods. Trade infrastructure components consist of transportation systems, ports of entry, and inputs such as electricity, and information and communication technology (ICT). The lack of consistent infrastructure linking production and consumption zones to international trade gateways places the region at a competitive disadvantage from the standpoints of service capability, service reliability, and costs. Targeted efforts to improve infrastructure within some of the countries have demonstrated success. However, because the countries are dependent on one another in terms of infrastructure needs, a seamless infrastructure system is needed; therefore, such targeted efforts, although helpful, do not address greater regional imperatives. This phenomenon is a consistent issue across the spectrum of regional infrastructure components.

Physical Infrastructure: Inadequate Roads, Seaports, and Airports[17]

Roadways, seaports, and airports comprise the major trade infrastructure systems in Central America. Major thoroughfares vary from well-maintained, modern, high-capacity, four-lane highways to poorly designed, poor quality, low-speed, two-lane roadways. Bypass corridors around population centers are generally nonexistent. Moreover, high-speed vehicular traffic is not segregated from pedestrian and nonmotorized vehicle traffic on the region's roadways. As a result, such impediments to free flow of traffic cause delays in trade shipments.

Although efforts to improve these systems are ongoing, they are uncoordinated regionally, and the resulting scatter-shot approach does not benefit the region in the longer term. For example, El Salvador, which is highly dependent on linkages to its neighbors for access to Caribbean Coast maritime gateways as well as imported electricity inputs for manufacturing, has successfully deployed a high-capacity, quality network of roads. Without coordinated efforts with its neighbors, however, El Salvador's recent investments will yield less than optimum returns to its economy as they will not connect to equally developed systems. As such, a coordinated approach is needed.

Major maritime and airport gateways lack sufficient infrastructure and operating space to cost-effectively transfer goods. For example, because processing capacity does not meet current needs, Costa Rica's Caribbean port at Limón requires offsite storage of containerized cargo, resulting in high costs associated with drayage, double handling, and traffic delays. Seaports also exhibit high variability with regard to administration, including publicly owned and operated seaports, landlord port authorities, and privately operated ports. Airport passenger and cargo handling facilities vary significantly within the region. These inconsistencies affect aircraft deployments for operators, airlift capacity for the region, scheduling, and turnaround reliability. Additionally, several international passenger terminals have passenger contamination issues, which negatively affect the security of the facilities. The variability in both exit and entry for goods results in significantly different operating costs and resultant costs to system users. Such variability hurts the region's competitiveness as a whole; for example, goods that leave from a cheaper port but incure greater overland transport costs makes such business transactions less attractive.

Services Infrastructure: Poor Electricity Distribution

The region's electrical power generation, transmission, and distribution infrastructure suffers from inconsistent capacity, reliability, and organizational structures. Costs associated with power generation vary significantly between countries because of the variability in energy sources used and, in many cases, are far higher than they need be. The capacities of countries that are currently net importers of electricity are inadequate to meet needs and normalize costs. Further, various distribution networks in the region suffer from high technical losses because of poor transmission equipment and individuals illegally tapping into the power supply, which lowers the availability of electricity and increases its costs to consumers. Lastly, throughout the region—to varying degrees—electricity is provided through overt or thinly-veiled monopolies. Such noncompetitive practices often lead to unassailable organizational structures, inefficient service, and higher costs to consumers. Accordingly, the added expenses of doing business further limits opportunities for growth.

Infrastructure challenges, therefore, are widespread. Given the interconnected nature of the countries in the region, addressing them on a regional level is the only adequate means to ensure long-term improvements.

Inhibiting Reform: Constrained Budgets and Inefficient Public Financing for Trade Services

The lack of funding for addressing trade facilitation is another major barrier. In general, the use of public funding is a challenge, as it entails making difficult choices about scarce resources and these choices pose an even greater dilemma for developing countries. In Central America, this issue takes on a special significance with respect to trade, because trade-related institutions are primary revenue collectors and customs agencies are the main collector of import duties and taxes. This section identifies some key funding barriers and their impact on the primary areas of trading systems, particularly those related to the three problematic areas identified above: processes and procedures, security, and infrastructure.

Inadequate and Inefficient Budget Allocations

A recurring discovery during the assessments was that rightful funds, fees, and budget allotments for trade-related agencies are being redirected to other government agencies. These losses are not due to corruption or mismanagement, but to budget priorities. However, these funding detours keep trade-related agencies from growing to meet the demands being placed on them by international trade. In one country, for example, by law the customs agency should receive over 3 percent of its collected revenues for its own operations. However, the government only provides 2 percent because of national budget problems which is, in effect, a cut of over 30 percent of available funds. Further, this same customs agency should receive revenues from auctions of seized and abandoned goods, but this money is diverted as well.

Perhaps a greater problem is that the limited funds that are available are often used for funding key services within a country that would be better and more efficiently funded on a regional basis. Numerous basic, trade-related functions, such as risk management, various training, immigration, and agriculture inspection, are funded nationally. The limited domestic investment that goes into these functions produces poor services. These services could be greatly improved if existing funding was applied on a regional basis.

Impacts of Constrained Budgets

Poor funding significantly affects the trading system's processes and procedures, security and infrastructure. For processes and procedures, and, more specifically, for the personnel that implements them, a lack of funds limits the quantity and quality of the available personnel for trade-related public institutions. For example, in several countries, customs officer salaries are extremely low, approximately $300 a month. Inadequate compensation leads to poor recruitment, low incentives for providing quality services, and high incentives for corruption. Poor funding also significantly affects training, which adds to the process and procedure problems described above.

Inadequate funding restrains trade-related agencies from acquiring basic modern equipment needed to improve trade facilitation through better automation, analysis, examination, and processing, i.e. those things that would provide greater efficiency throughout the system. For example, modern container examination tools, such as density meters, would provide less intrusive, more rapid, and more accurate inspections. Customs and police officials could, with confidence, efficiently process compliant goods and identify smuggled goods without intrusive and time-consuming removal of items from containers. Moreover, inadequate funding prevents the adoption of an all-electronic clearance system that would provide more rapid processing, more transparent processes, and better-targeted risk-management system. For example, Nicaraguan customs lacks the ability to fully conduct electronic clearance because of poor network infrastructure; although declarations are transmitted through the Internet, release notifications cannot be received electronically. Further, Nicaraguan customs lacks the appropriate hardware, having only approximately 140 workstations to serve the entire country and maintaining all server-type information on a single workstation.

Another widespread deficiency is inadequate laboratory facilities as existing laboratory facilities are small, understaffed, and underequipped. These facilities need equipment and resources to better determine proper classification of goods and identify areas of concern. In some cases, samples are sent to Mexico or the United States for analysis, which is expensive and causes major delays.

The lack of adequate funding means also that internal security imperatives cannot be met. As a result, businesses will be forced to continue to incur initial *ad hoc* security costs. As mentioned, these include armed guards and continuous monitoring of shipments in transit. Further, the lack of funding for security means that borders will remain relatively porous, allowing unregulated goods to enter the market and causing unnatural fluctuations in the market. Such security costs will therefore either be internalized by the business, hurting their competitive position, or born by the consumer as goods will be more expensive.

Additionally, the region's overall low borrowing power for trade-related projects—set in part by the limited resources available to those agencies whose agenda is trade focused—limits the availability of funds for large-scale infrastructure projects that are needed to improve trade. Today's world of globalized trading patterns puts significant pressure on a region to effectively demonstrate the economics of a trade improvement project prior to funding. Although privatization of public infrastructure components has been demonstrated as one solution to this dilemma, this route remains difficult for the CAFTA countries because businesses require cost-effective, reliable services to justify investment. Going forward, cooperation between CAFTA countries to efficiently allocate limited funds for improvements will be critical to building the business case for large-scale infrastructure investments.

The Commercial Environment: Challenges to Entrepreneurship and Growth

The examinations of the five CAFTA countries detailed numerous issues with respect to the state of commercial law and institutions. First, and perhaps most important, the process of launching and growing a new business in any of the five countries is difficult. The dual obstacles of accessing capital and navigating bureaucratic mazes are just the beginning of the difficulties facing a new company. The life of the business, particularly micro, small, and medium-sized enterprises (SMEs), is made all the harder by barriers in contract enforcement, the inability to properly secure both real and movable property, and a disorderly and out of date liquidation process in the event of insolvency. Although the country reports propose solutions for these issues as they apply in their respective country contexts, the suggestions therein are all made against the vital backdrop of regionalism. That is, without harmonization of commercial legislation and best practices throughout the region, homegrown businesses and outside investors will be less able to seize the economic opportunities presented in this emerging market of 36 million people.

Certain other commercial law and institutional issues that affect the life of a company are significant and timely in the context of CAFTA, particularly for larger, more established companies. A poor state of corporate governance, in particular weak management principles and a lack of overall transparency, means that the potential for outside investment is lessened. In addition, the weakness of stock markets in the region significantly inhibits the growth potential of companies. Finally, the opportunities afforded by sound and consistent competition law and policy are not available or not yet being fully effected.

The issues set forth in this section represent more than a collective list of national problems—they are, again, regional issues that are of particular timeliness as the five member countries seek the potential benefits of CAFTA. For example, there is a lack of public confidence in the courts of several of the CAFTA countries. The absence of a regional approach to improving the courts presents a concern that individual country reforms will be made without sufficient consideration of what the other countries are doing. Harmonized practices, in everything from the automation of courts, to litigation and enforcement procedures, to continuing legal education and anticorruption efforts for judges, would strengthen the position of all five countries as a worthwhile regional market for investment. Similarly, the crisis in accessing capital could be significantly ameliorated by regionwide adoption of the OAS Model Inter-American Law on Secured Transactions. The need for a more regionalized approach is in many ways as important for commercial law as it is for trade facilitation. Of course, the costs inherent in dealing with these problems is a difficult hurdle to overcome but is made easier by understanding the exact nature and effects of the problems and therefore being more able give them priority. Given the interconnectedness of the CAFTA countries, inconsistent laws and inadequate institutions in one nation may well affect the success of another; in short, the sum is greater than its parts. This theme is accentuated throughout this section, and further detailed in the discussion of commercial law and institution recommendations.

Obstacles, Red Tape, and Pitfalls: The Life of a Company in the CAFTA Region

Entrepreneurs who seek to establish, build, expand, or even shut down a business within the CAFTA region face serious obstacles. As demonstrated countless ways during the individual country assessments, SMEs in the CAFTA region are expected to shoulder overwhelming administrative costs. They must struggle through an inordinate number of bureaucratic procedures. The forward-looking processes of accessing capital to start a business; registering a company, collateral, or real property; or seeking enforcement of contracts and debt, are regularly defeated by high costs, illogical and ineffective bureaucracy, or corruption. Further complicating matters, the quality of professional services available to support businesses—particularly legal services—is often weak.

Among the most troublesome consequences of these obstacles is the rate at which entrepreneurs elect to bypass the formal sector. Recent World Bank findings document the extent to which many businesses in the CAFTA region remain part of the informal economy (See Figure III-2).[18]

Compared with the 2003 average informal economy rate of 16.8% for countries belonging to the Organization for Economic Cooperation and Development (OECD), these rates are alarming. Where businesses remain informal, workers are deprived of access to health benefits, pensions, social security, and protection from abuse. The national treasuries fail to receive the taxes they need to support the country's infrastructure—the very roads, ports, electrical lines, and other resources that support a vibrant economy. Products remain unregulated and companies are in many instances run inefficiently and even dangerously.[19] Internationally sanctioned principles of corporate governance are generally disregarded, thereby weakening opportunities for attracting outside investment.[20] Finally, the operators of these informal economy companies are more likely to be estranged from the political system, thus undermining a country's access to the benefits of stability and democratic participation.[21]

Figure III-2

Country	Informal Economy
Costa Rica	26.2%
El Salvador	(undocumented)
Guatemala	51.5%
Honduras	49.6%
Nicaragua	45.2%

Source: World Bank, Doing Business (2004)

Where can CAFTA-region countries reduce the obstacles, red tape, and pitfalls that restrain entrepreneurs in their efforts to establish or expand a company? What are the opportunities for doing so on a regional basis? An examination of the life of a company in the CAFTA region illustrates the many opportunities for reform.

The Lifeline of a New Company: Access to Credit

An individual, family, or group of acquaintances that wishes to form a business needs more than a good idea and a sound plan for operations—they need money. In many wealthier countries, bootstrapping, through a combination of personal savings, barter, and easily accessible credit (credit cards in particular), has become a common approach to launching a new business. In addition, banks often serve as short-term lenders, offering demand loans, seasonal lines of credit, and single-purpose loans for machinery and equipment. The opportunity to use collateral to secure a business loan—including real property, movable property, revolving property (such as business inventory), and even intangible property—is an aspect of economic freedom that is virtually taken for granted in the wealthier countries.

In contrast, in the CAFTA region, straightforward access to startup funds is rarely available. Entrepreneurs almost invariably lack access to capital beyond what can be marshaled among family and friends. In Nicaragua and Guatemala SMEs find themselves having to pay interest rates anywhere from 20-50 percent per year from private lenders (including nongovernmental organizations, associations, cooperative companies and microfinance corporations) that are willing to risk dealing with smaller companies and offer simpler and non-real-estate-based lending solutions. In El Salvador, loan guarantees against movable collateral typically require high overcollateralization; that is, the lender may loan as little as 20 percent or less of the collateral's value. Similar difficulties are repeatedly cited in each of the other CAFTA countries. Moreover, loans are typically made on the basis of movable collateral only when the business is well established and the immovable property has already been secured. In Costa Rica, although the commercial code states that a pledge may include any type of movable property, its listing of the collateral that can be pledged includes mostly tangible goods and goods capable of registration by detailed individual description and serial number. As a result, entrepreneurs who do not own real property have little chance of obtaining a loan at startup, and established businesses will struggle to obtain capital needed for growth.

Why the dire state of accessing capital in the CAFTA region? Simply, lending institutions have no faith that, in the event of nonpayment, they will be able to collect upon the loans they make. The existing commercial laws provide no trustworthy mechanisms for structuring loan guarantees against movable collateral, with the option of efficient foreclosure in case of default. Moreover, prompt, nonbureaucratic, and effective court action, based on reliable information garnered from the country's formal registries, is simply not a reality.

There are a variety of efforts throughout the CAFTA region—funded both locally and by outside donors—to support SMEs, particularly with respect to their startup costs. For example, the Honduran Council of Private Enterprise (COHEP) has proven to be a promising organization with respect to fostering business startups and has $200,000 available for SME financing. With these funds, provided by the government of Taiwan, the organization grants loans of up to $5,000 to SMEs under flexible terms. That said, businesses that "graduate" from COHEP support find that the environment for continuing their operations as a new enterprise is difficult and hostile and that further support for their continuing activity is almost impossible to find.

Unfortunately, the effectiveness of organizations such as COHEP is limited, not only by high interest rates and guarantee requirements, but also by a lack of coordination of similar initiatives throughout the region. When turning to organizations other than banks for startup assistance, new businesses must spend significant energy getting to know the processes and restrictions of each. Greater coordination would reduce these transaction costs.

The heart of the access-to-capital problem lies in the insufficient capacities of the public institutions that are charged with supporting the process of borrowing and lending money. These institutions include both the courts and the registries that are supposed to formalize property rights for the purpose, among other things, of enabling entrepreneurs to draw upon the capital found in their assets. As documented throughout the country reports, several of the real property and collateral registries in the CAFTA region have proven slow, unduly formalistic in their requirements, unreliable, inaccessible to the public, and, in some instances, corrupt. Rather than serving to override weaknesses in the registry systems, judges too are highly formalistic, and the courts are ultimately ineffective when it comes to facilitating the ability of lenders to be repaid.

Weak institutions undermine the efforts of entrepreneurs at the very beginning of a company's existence. Until these institutional realities change, little can be done to lower interest rates and otherwise release constraints on access to capital.

The Grey Market: Bureaucratic Disincentives to Joining the Formal Economy

Against the backdrop of limited or nonexistent access to capital, new companies in the CAFTA region are required to go through various processes that will allow them to become legal entities. Most countries in the world require registration and regulation of new companies. A new business typically must register with state and local institutions, assume the burden of taxation, and submit to regulation by a variety of state and municipal agencies (including those pertaining to licensing, employment, occupational safety, the environment, and other issues).

The expectations faced by new companies in the CAFTA region, however, are far more formidable than those found in other countries. The burdens inherent in these procedures, as documented by recent World Bank statistics (and compared against OECD averages), are alarming (See table III-3).

Given these figures, the fact that 30 to 50 percent of new businesses in the CAFTA region decline to join the formal sector is not surprising. The slow process and high fees for opening a small business in CAFTA countries increase startup capital needed and lower overall profitability in the most crucial

Figure III-3

Country	Cost of Business Startup as a % of per capita income	Number of Days it takes to register	Number of Procedures
Costa Rica	25.7	77	11
El Salvador	128.0	7	12
Guatemala	62.8	39	15
Honduras	72.9	62	13
Nicaragua	170.1	45	9
OECD Avg.	8.0	25	6

Source: World Bank, Doing business (2004).

years of company operation. Inspections, licenses, approvals, and certifications each represent costs that are all higher than necessary, and altogether they impose significant obstacles to successful investment.

Moreover, businesses often opt to remain unincorporated in the CAFTA region for the purpose of avoiding the many taxes such as those levied on corporate revenues, enterprise assets tax, value added taxes (VAT), consumption taxes, sales taxes, and municipal taxes. This complex and burdensome tax structure is a powerful disincentive to entering the formal economy, especially when the benefits of formalization seem so slight. In Nicaragua, one company reported that, for every dollar it received in revenue, it paid 31 cents in taxes before income taxes were levied. In Honduras, the "solution" to tax collection problems has been the imposition of new taxes—truly a vicious cycle. Similarly, in Costa Rica, the Inter-American Development Bank determined that tax administration policy entails the investment of about $2 for every $1 in taxes collected, thus driving up the cost of the bureaucracy and, hence, the need for more tax revenue.

There is little regional consistency in the application and collection of corporate taxes, although, as one promising development, efforts are underway to harmonize the VAT. Additional regional

Improving Access to the Formal Sector: Improvements to the Company Registry in El Salvador

In the recent past, the company registry in El Salvador lacked the capacity to handle the large quantity of registrations it received. Good management and a will to reform have resulted in dramatic improvements in the Registry's capabilities over the past year. The Registry is now highly automated, has well-trained officers, and is readily accessible. Companies seeking to enter the formal sector receive a certificate of registration typically within 72 hours. Registry personnel prove well motivated and enjoy their access to modern equipment.

Moreover, registration fees are not high. In the case of incorporation, fees are determined by the capital of the registering company and cannot exceed $5,700. To incorporate a company whose capital ranges between $11,428.57 and $57,142.86, registration fees would be $91.43. These revenues are devoted to funding Registry operations, as the Registry does not receive funds from the central government.

Currently, the company registry is centralized. Some regional offices exist, but these offices can only receive documents. Given the size of El Salvador, however, centralization does not seem to be a major problem. Plans for increasing the capacity of regional offices are underway. It currently is not possible to register a company on-line, but plans to allow incorporation via the internet and create a network between government offices have been drafted. Once this network has been completed, it is expected that all business registrations could be conducted electronically at a virtual one-stop-shop.

improvements in tax policy are necessary to support the attractiveness of CAFTA countries as a regional market for investment.

The Power of Property: A Key to Company Growth

The crucial role that property plays in the ability of businesses to grow and expand has been of enormous interest since Hernando de Soto published his groundbreaking work, The Other Path, in 1986. As summarized in an article published by the Center for International Private Enterprise, Mr. de Soto identified the barriers to private sector growth that had been invisible to others. The key barrier, he argued, has long been weak institutions . . .

> Perhaps the most important—and least noted—of these institutions is property rights. Owners of land, corporate shares, and even intellectual property are loath to invest in the upkeep and improvement of their property if their rights as owners are insecure. Just as importantly, if property cannot be bought and sold with the confidence that the authorities will uphold the transaction, the market itself will fail to generate dynamic growth. Indeed, the absence of property rights is one factor that drives people out of formal markets into the informal sector.[22]

Clear property rights represent a fundamental precondition for market-based economic activity. The grant of ownership or ownership-like rights in real property to rural or urban residents makes it possible to realize the full value of the property, both in its primary role (housing, infrastructure for business, garden plots, crop cultivation, etc.) and in its secondary role as collateral for consumer or commercial credit. Similarly, the registration of movable collateral in a state-sponsored institution reduces the risk of issuing credit, leading to an increased availability of credit on improved terms.

Throughout the CAFTA region, property rights have been recognized for more than 300 years. The economic opportunities inherent in real and moveable property have yet to be realized, however, because of the ineffectiveness of processes meant to record and validate these rights. Specifically, the institutions through which ownership of property is validated—including real property registries, land cadastres and even the courts—need reform. Certain aspects of the legal framework would also benefit from revision.

Real property. In the area of real property, land cadastres and real property registries in the region are failing to serve their purpose: information is not updated; there typically is no linkage among institutions; there is inadequate or no automation; and low to moderate corruption is pervasive. As documented by the World Bank, the time it takes to register property in the CAFTA region is far too long, nearly twice the time required in OECD countries.[23] (See figure III-4)

An important bright spot to note is the relatively low cost of registration in three CAFTA countries as a percentage of the property's value. Other problems, however, overshadow this positive. For example, in Nicaragua, postrevolution titles on many properties are uncertain; in some cases, two or even three parties claim title to the same property. Zoning is chaotic, and, because of the uncertainty of land tenure, mortgages—the only widely accepted form of collateral—are often rejected as guarantees. The real property registry of Nicaragua is not automated and information is handwritten into record books. In some provincial registries, records have been damaged by water and information has been lost.

Similarly, in Honduras, only about 14 percent of the population occupies property legally. The remaining 86 percent of illegally held property amounts to $12.4 billion in extralegal land possession. Of properties held legally, only 30 percent are registered. Consequently, only a very small percentage of the population in Honduras has access to credit, since in

Figure III-4

Country	Days expended in registering property	Cost of registration (% of property value)
Costa Rica	21	3.6
El Salvador	52	3.5
Guatemala	55	2.4
Honduras	36	8.8
Nicaragua	65	6.5
OECD Avg.	34	4.9

Source: World Bank, Doing business (2004) most cases credit is only available to those holding valid title to real property.

That said, a major reform in the area of real property is currently being implemented in Honduras through the Ley de Propiedad (Law of Property), which entered into force on June 29, 2004. The primary purpose of the law is to rationalize the country's chaotic property system by recognizing settlers' rights, resolving title disputes and modernizing the property registry. The law includes the creation of a new entity in charge of property matters, Instituto de Propiedad, which, as early as January 2005, will have authority over real property registration and the cadastre. This new law includes a transition period during which information from current registries will be transferred into the new system. Honduras' Ley de Propiedad should be carefully watched for its lessons learned and possible applicability regionwide. Indeed, as each CAFTA country is challenged to increase automation, streamline procedures, and become more customer-oriented in their property registration systems, the case for a regional approach to these fixes is obvious.

Movable and intangible property. With respect to the registration of collateral other than real property, common themes have emerged throughout the CAFTA region, including the need for improvement in both secured transaction laws and institutions. Specific findings include the following:

- *Inflexible laws that limit allowable types of collateral.* Laws in the CAFTA region tend to restrict the type of property that may be used as collateral for loans to easily identifiable property. For example, in Costa Rica and Guatemala, borrowers may not use certain "modern" types of collateral, including revolving inventory, to secure a loan.

- *Excessive collateral and guarantor requirements.* Typical debt-to-collateral ratios are so high that they unnecessarily tie up capital—including cash deposits for security—which might be needed to respond to market opportunities.

- *Registries.* Issues that affect the unencumbered functioning of collateral registries in the region include the following:
  - Most collateral registries require submission of the entire document that creates each security interest, rather than permitting a single registration of a summary document to set priority for a given creditor for a series of secured loans thereafter.
  - The registries do not recognize many types of collateral.
  - Automation is limited. In some offices, everything is done by hand, thereby allowing corruption and incurring delays.
  - Public access to registries is too often slow or impossible.

- *Corruption*. In a few cases, corruption at the registries is cited as a problem that routinely obstructs activity and discourages public confidence in future borrowing or lending activity.

As discussed in the recommendations section, the OAS Model Inter-American Law on Secured Transactions provides a context in which these obstacles may be overcome. The costs and challenges of adopting the law and otherwise reforming property-related institutions in the CAFTA region are substantial, but they should be considered in the context of the overall environment for enterprise growth. As summarized recently in the Economist,

> Laggards sometimes argue that reforms would be difficult and costly to enact. But what could be simpler than scrapping a stupid rule? Simplifying procedures is harder, but not too hard. There are plenty of examples to learn from, and the World Bank estimates that the benefits of the reforms it advocates are 25 times the costs.[24]

Corporate Governance: A Path toward Greater Investment

Established businesses in the CAFTA region that seek increased access to capital must consider how they look in the eyes of a domestic or foreign investor. Although there are relatively few publicly held companies in Central America, this is true even when the company is privately held. In other words, those businesses must ask: What is the risk that an investor faces by getting involved with the business?

Risk analysis has many components, having to do both with factors beyond the company's control, such as the quality of the courts, the country's security situation, the market for goods, the local infrastructure, etc., and with factors very much within the company's control, such as the quality of its record-keeping, the professionalism of its officers and directors, the transparency of its production processes, the soundness of its employee relations, and so forth. The latter items constitute matters of corporate governance, an area that holds considerable room for reform in the CAFTA region.

It is clear that corporate governance practices are not consistently practiced by businesses in the CAFTA region. In Costa Rica, for example, the law does not include strict requirements on accounting, public disclosure of information, board meetings, shareholder rights, or independence of board members. In Honduras, companies are required to appoint internal auditors, or *comisarios*, to supervise company administrators, but, in fact, these auditors are rarely appointed. When *comisarios* are appointed, they often are not independent and may even be shareholders of the company in question. Similarly, in Nicaragua, the strict auditing principles of the U.S. Sarbanes-Oxley Act, which apply to Nicaraguan companies doing business in and with the United States, are barely understood or applied.

Thus, in the CAFTA region, the following corporate governance items warrant significant scrutiny:

- *Ownership and control.* There is a high degree of concentrated ownership and control over individual companies or groups of companies in the CAFTA region. Although concentrated ownership by individuals or families may have positive aspects, such as careful oversight of a company's management, the interests of the controlling owners often conflict with those of minority shareholders and controlling shareholders often extract private benefits from the company. Moreover, large companies in certain of the CAFTA countries, many of which have strategic functions in the economy (such as telecommunications, electricity, water, and oil) continue to be controlled by the state. In many instances, state control results in inefficient management practices and a conflict between the state roles as both owner and regulator.
- *The role of company boards*. Many company boards in the CAFTA region fall into one of two patterns: The board is entirely passive and merely rubber-stamp the actions of management. Or the board is essentially a family operation that engages close relatives to serve in powerful executive positions. Possible contributory solutions to the lack of board independence may include changes to the company law that make greater use of independent board members, require that a certain portion of a board be selected directly by minority shareholders, strengthen the duties of loyalty and care, or enhance the role of board committees, such as audit committees.
- *Information and disclosure*. Disclosure of company information, or at least availability of this information to potential investors, is a significant issue, and should include the following categories of information:
  - Consolidation, accounts payable and receivable, and other liabilities including guarantees
  - Ownership and control
  - Related-party transactions
  - Material events, such as planned transactions and other events that may have significant impact on shareholders and the company
  - Executive and board-member remuneration
  - Company policies and objectives
  - Board-member profiles.

Each of these corporate governance items directly pertains to the risk that potential investors face when committing themselves to a company. Better governance reduces investor risk, thereby improving the company's chances for expansion and growth.

Going Public: The Limitations of Stock Markets in the CAFTA Region

Outside investment in a company is a means of growth taken for granted in many developed nations. In the CAFTA region, however, the institutional support for public purchasing and exchange of company shares is weak. For example, the regional air carrier, TACA, sought in the past to raise funds through bonds, but because the steps proved so different in each of the CAFTA countries and the process would have had to be repeated five times, the company ultimately resorted to Panama to raise its funds. In fact, an important finding in the country reports is that, with respect to public exchange of company shares, a regional approach would be more effective than individual solutions. Various improvements could be made in this regard: laws within the CAFTA region of stock markets/exchanges should be harmonized; and a regional private sector working group should be created to establish a truly functional regional stock market. Such advances would allow foreign and regional companies greater regional opportunities.

A Level Playing Field: Competition Law and Policy

Once established in the CAFTA region, companies face the challenge of survival. Absent viable competition laws and policies (as is the case in most of the region), however, the benefits of trade liberalization will be limited if anticompetitive business practices and state interventions continue to act as barriers to trade. If the CAFTA countries intend to reap the advantages of regional integration, the strategy of market reform without sound competition policy and without a comprehensive competition law merits reconsideration.

Until recently, Costa Rica was the only CAFTA country with a national competition law, which it enacted in 1994. Driven in part by preparations for CAFTA, however, in 2004 the other four countries took significant steps to pass national competition laws. In November, El Salvador passed a competition law, and Honduras and Nicaragua currently have drafts before legislative committees. These efforts are laudable, but would benefit from increased coordination at the regional level because of the small size of the economies, the number of existing and potential cross-border investors, and the sophisticated nature of competition analysis.

As the individual country reports demonstrate, the Central American countries share similar challenges created by business communities that are poorly informed about competition laws and a lack of policymakers who are sufficiently trained in this complex area of law. Regional solutions can address many of these shared challenges. Regional harmonization, or at least convergence, of substantive provisions of the competition laws and merger notification procedures would be an important first step. The Hondurans have made progress in the direction of regional cooperation, through dialogue with Costa Rica, Panama, and Mexico as they draft a competition law. Regional harmonization would provide a more attractive environment for investment, initially by facilitating education of the business and legal communities and the training of competition authorities and later by promoting certainty among the investor community and allowing interagency cooperation and coordination at the policymaking level. Although the solutions to the delays and/or corruption of the court systems are not readily apparent, regional training programs for judges can improve the quality of decision-making. The Recommendations section provides further steps that countries can take in this direction.

Seeking to Enforce a Contract: Foiled by the System

It is arguable that the single most important nonmarket risk for companies doing business in the CAFTA region is the lack of predictable, affordable enforcement in the event of a contractual or other commercial dispute or, more broadly, in the application of any areas of law discussed in this report and the individual country reports. The courts are slow to issue judgments, and once they do, the judgment may not be enforceable, at least not within a reasonable time frame and at a reasonable cost. Without enforcement, commercial rights are no more than theory. Although courts should not be the first resort in a commercial dispute—businesses should be well practiced at lawful, out-of-court attempts at collection—once needed, they are the last resort. Today, they function poorly at best.(See Figure III-5)

Enforcement problems increase the risk of

Figure III-5

Country	Days expended in enforcing a contract	Cost of enforcement (% of debt)
Costa Rica	550	41.2
El Salvador	275	12.5
Guatemala	1459	14.5
Honduras	545	33.1
Nicaragua	155	16.3
OECD Avg.	229	10.8

Source: World Bank, Doing business (2004)

bankruptcy or other serious financial troubles. Increased risk impacts SMEs in particular—they are less able than larger companies to survive when a customer fails to pay—but the greatest impact is indirect. Banks and other credit-providers manage risk by increasing the costs of their products and services, increasing the collateral requirements, or both, or by simply refusing to grant credit. Such responses have dire consequences for individual businesses and for the economy at large.

Courts. Time spent in court is time spent away from the company. Similarly, the failure of a court to enforce a contract in a reasonable time represents a loss for a company, and the smaller the company, the greater the impact of the loss. A central theme that arises in each of the country reports is the fundamental need to improve the courts. Although the nature and extent of the problems varies among the individual countries, an increase in public confidence in judiciaries across the region is an essential aspect of bolstering the growth potential of local businesses and the willingness of outsiders to invest in the region.

Among the most important crosscutting observations concerning the various court systems in the CAFTA region is the rigid adherence by judges to procedural formalism, as opposed to a solution-oriented approach to commercial cases. Although judges may succeed in dutifully expounding upon the letter of the law, they often fail to account for the laws' purpose and do not draw attention to legislative deficiencies when they are forced to render a decision that obstructs future economic activity.

One common explanation for the judicial inclination toward form over substance is the widely held impression that, with respect to commercial issues and disputes, many judges lack an adequate understanding of the law. This assertion derives from an accumulation of factors: weak legal education; an absence of sustained opportunities in continuing legal education; and, significantly, the design of the court systems which generally does not allow judges to develop specialized knowledge. Particularly in many rural areas, where a single judge decides commercial, criminal, family, labor, and tax matters, there is no opportunity to develop expertise in modern and evolving commercial law concepts. Additionally, there is a lack of understanding about international law concepts, such as the treaties and conventions to which the country has subscribed.

Not only judges, but also court staff need more and better continuing education. Court staff ideally should have expertise in a variety of court administration disciplines, including internal controls and auditing functions, budget management, court security, procurement and contracting, human resources management, and, of course, information technology. In this regard, both judges and court staff would similarly benefit from interaction with their peers in the other CAFTA countries.

One significant area in which the effectiveness of courts is limited unnecessarily is that of the authentication of documents, which can be crucial for companies trying to do business in neighboring countries. The procedures judges use for recognizing the authenticity of business contracts, documents evidencing property ownership, or registration of collateral, are often unclear or inconsistently administered, thus increasing transaction costs. In more than one CAFTA country, foreigners have complained that a document notarized abroad, such as a power of attorney, is not valid without passing through the lengthy procedure of legalization. Even thereafter, the document needs to be locally notarized. Further delaying the process, the CAFTA countries have taken very few steps toward the recognition and authentication of electronic documents and signatures.

Problems with power of attorney arise regardless of whether the CAFTA country is part of the Inter-American Convention on Legal Regime of Powers of Attorney to be Used Abroad. In Costa Rica, the only country which is a member of the Convention, notaries, judges, and lawyers report that a power of attorney granted in a signatory country still is not valid if it is not notarized by a local notary. In CAFTA countries that do not participate in the convention, the process is several steps more cumbersome.

Finally, several of the country reports land on the problem of corruption among judges and court staff. Specific complaints emerging from certain of the CAFTA countries include the following:

- Corruption is found at all levels of the formal dispute-resolution process, including notaries, lawyers, court clerks, and judges (particularly criminal judges). Significant delays in justice occur, it is claimed, because lawyers and judges receive bribes. The perception of corruption of court personnel varies, but is cited to some degree in each CAFTA country.

- The strong influence that politicians have over the judicial branch in various CAFTA countries is routinely cited as an issue, as evidenced in the appointment and removal of judges for the purpose of punishing independence or performing political favors.

- In many cases, corruption is an accepted practice of doing business—the problem is, indeed, a two-way street. Many companies in the region are accustomed to and comfortable with making illegal payments to effect the outcome of their interests.

- Corruption and influence peddling in the judicial branch is said to put foreign investors at a sharp disadvantage in any litigation or dispute.

Anticorruption initiatives can incorporate such approaches as short and long-term technical assistance, resident advisors and mentoring, training curriculum development and execution, and public information programs.

Lawyers. Both homegrown companies and outside investors need good local lawyers for all aspects of their business, including the drafting and enforcement of contracts. The individual country reports identify a series of limitations in the professionalism of lawyers throughout the CAFTA region: (1) the basic education of lawyers, particularly as it pertains to commercial law topics, is generally weak; (2) there are few professional requirements, such as a mandatory bar exam or required continuing legal education; and (3) bar associations tend to be relatively informal and are far from achieving their potential for developing the professionalism and minimum standards for lawyers in the region. Moreover, the absence of meaningful coordination among the countries in basic standards for legal education and professionalism undermines the confidence outsiders can have in the capability of all lawyers throughout the region.

First, the system of educating lawyers throughout the CAFTA region is said to be in need of significant reform. The intensely formalistic approach to the law, both by judges and practicing lawyers, can be said to result from their training from the outset—namely results-oriented thinking is rarely encouraged or rewarded in either law school or during a lawyer's career. Although there are many sound legal programs and strong legal educators, certain countries have law schools that serve as diploma factories, thus harming the profession as a whole. In general, basic legal education does not effectively address modern international business, commerce, and trade practices and concepts, which leads to a lack of sophistication of most lawyers and legal professionals.

Second, the CAFTA region countries impose at best inconsistent professional requirements on their lawyers. For example, there is no tradition of testing law graduates as a condition for their being allowed to practice. Nor are there any minimum requirements in continuing legal education, which similarly might improve both the knowledge of lawyers and the degree of public confidence in legal professionals.

Third, the weaknesses of, or in some instances absence entirely, of professional bar associations results in a lack of a sense of professionalism or common standards—including ethical standards—among lawyers. By providing opportunities for sharing experiences, managing law practices, and training in substantive areas of the law, including the ethics of the legal profession, bar associations have the potential to enhance the competence and expertise of practitioners. In addition, weaknesses in bar associations represent a missed opportunity for advocacy pertaining to the updating of laws and the regionalization of the profession.

Alternative Dispute Resolution. The term alternative dispute resolution (ADR) refers to methods by which legal disputes are resolved in ways other than by formal litigation in the public courts. In CAFTA countries, ADR usually manifests in the form of arbitration, mediation, or conciliation.

No matter the form, ADR typically involves a process much less formal than the traditional court process and includes the designation of a third party to preside over a hearing or discussion between the parties. ADR represents an enormous opportunity for businesses seeking more efficient and effective methods of dispute resolution, including the enforcement of contracts.

The extent to which ADR is actually being engaged, however, varies among the CAFTA countries. From a legal environment in which alternative approaches were almost never considered, for example, El Salvador has recently initiated efforts to develop ADR, including the enactment of a new law and the establishment of a new arbitration center. The process of training lawyers and arbitrators in ADR, gaining the confidence of businesses, and getting courts to enforce the results of ADR requires enormous and continuous effort. Regional resources and commonalities in procedures would certainly assist in this respect.

The End of the Line: Liquidation and Restructuring

Good bankruptcy laws properly applied can relieve honest debtors from crushing financial difficulties, account for all of the debtor's assets and make them available to creditors, sort out priorities among creditors, and enforce creditors' guarantees against particular items of collateral. The very existence of a clear and enforceable legal framework for insolvency has an important role to play in fostering economic growth: where creditors can reasonably anticipate that their investments are protected when an indebted enterprise falters or fails and they will be able to seek and receive at least partial payment on the enterprise's debt, they are more likely to loan money or provide goods on credit. In addition, the opportunity for a company to restructure, or work itself out of debt means that some companies may return to viability and even profitability and so contribute to an economy's overall development, competitiveness, and employment level. Last, a viable framework for business insolvency, coupled in particular with a law of secured transactions and other regimes for enforcement of pledges, enables market participants to more accurately price, manage, and control risks of default or enterprise failure.

In all of the CAFTA countries, the insolvency laws are antiquated, lagging a generation or more behind the laws that regulate insolvency in more modern regimes. For example, the laws include provisions

A Positive, Growing Practice: ADR in Costa Rica

In Costa Rica, both the legal and business communities have supported efforts to promote the effective use of Alternative Dispute Resolution. The Costa Rican Chamber of Commerce and the American Chamber operate centers for dispute resolution. Professional associations similarly support centers for real estate, architecture, construction, and labor. Whether by accident or purpose, this division into specialties reflects a sophisticated approach to ADR, one that allows participants to benefit from the subject-matter expertise held by arbitrators. Although ADR in Costa Rica could benefit from greater promotion and better understanding on the part of judges who are asked to enforce awards and agreements, the commitment to ADR demonstrated to date is a positive development for the region.

for criminal investigations of reasons for the debtor's financial failure, with a presumption of fraud. Such requirements in the laws act as a strong disincentive to voluntary declarations of bankruptcy by debtors. As a result, companies have found alternative ways to deal with insolvency without involving the legal process. For example, some have set up trust mechanisms or retention of title schemes when they want to guarantee a loan. Such nonjudicial agreements are often secret liens, or agreements entered without knowledge of some of the creditors or bona fide purchasers. Other insolvent debtors simply close their doors and cease to operate rather than submit to bankruptcy laws. Moreover, most bankruptcy laws only provide for a liquidation procedure, as opposed to an effort to keep companies in business by means of reorganization or rehabilitation. Finally, although there is a role for bankruptcy administrators, it is often vaguely defined and highly inconsistent in practice. As a result, insolvency laws have fallen into such disuse that neither interest nor will to reform them exists in any CAFTA country. For all practical purposes, insolvency law and practice does not exist in the region.

The challenges in the areas of trade and commercial law, on both a regional and national scale, are real and significant. The costs in fixing these problems are real and significant as well, and no government or donor can fund all the necessary programs. However, as governments and donors will work to meet these challenges, it imperative that such efforts are done in the most beneficial manner. Taking into account the new context in which the CAFTA countries now find themselves, this section discusses ways to make such difficult decisions by giving tools to set priorities and showing how a regional approach to meeting any of many challenges can achieve the greatest efficiencies and benefits. Along with the specific recommendations for facilitating trade and improving commercial law and institutions, this section also separately suggests ways of dealing with an overarching theme that arose throughout the assessment process: corruption. Corruption adds nonobvious costs throughout the business cycle, from the moment goods leave a warehouse and enter the flow of commerce until a business is mired in the judicial system in an effort to enforce a contract. Taken together, these recommendations provide a strategy for meeting the imperative of improving Central American coordination, integration, and harmonization. By working to meet the challenges, CAFTA countries stand a significant chance of achieving the development they seek.

IV. Strategies for Improvement: Facilitating Trade Flows and Strengthening Commercial Laws and Institutions

Improving Regional Trade Facilitation

The Best Route to Reducing Trade Transaction Costs: Supporting the Customs Union

By far, the most important trade facilitation step for the region is the full implementation of the customs union. International agencies seeking to help CAFTA members develop trade should consider this among the highest of priorities. With the relatively free movement of goods throughout Central America, traders will reap the savings from less bureaucracy, fewer delays, and lower costs, and the CACM will come to represent a true common market for interested investors.

Although progress is being made, the customs union will not be a reality by the January 2005 deadline. The union will be completed in phases and transition periods are necessary. It is critical that the union does not simply represent moving the full bureaucracy to the outer borders of the region. It is also essential to balance the added efficiency with appropriate security. Simply removing security officials from border sites will not accomplish the job, nor will creating a multitude of roadside stops. Additionally, the customs union should provide equal priority to other essential, noncustoms trade functions, such as immigration, agriculture, standards, and health. For example, the customs union should include a harmonized CA–4 immigration visa, so that trade-related visitors may enter one country and visit all with appropriate security measures. With the implementation of the union, the region will take a momentous step toward greater harmonization and integration, improve its competitiveness.

Supporting the Customs Union

1. Assist the union in creating key streamlined procedures, including those involving export, import, sanitary, phytosanitary, and immigration.
2. Support regional automated connections so that systems talk to each other.
3. Aid the union in developing proper security controls. (i.e., regional risk management systems, regional security cooperation initiatives).

The union can be supported directly at the regional level in a number of ways, including the following: (1) assisting the union in creating key procedures for export, import, sanitary, phytosanitary, and immigration; (2) supporting the union in developing proper security controls (i.e., regional risk-management systems); and (3) aiding the union's

Making the Customs Union a Reality at the Guatemalan-Salvadoran Border

Guatemala and El Salvador took an enormous step in facilitating trade when the countries implemented a "borderless" crossing at the most significant commercial border point between the two nations in November 2004. The new crossing reduces transport costs and increases competitiveness for the countries by freeing goods and people from long delays, while maintaining security. The following highlights reflect the new system:

- While border posts disappear, controls do not. Through risk management and closer coordination migratory and commercial controls will be executed through selectivity process at check points in both countries.
- This move is enabled in part due to a tariff harmonization of 93 percent that will be increased in 2005 to 100 percent.
- A border crossing process that previously took 50 minutes for persons crossing will now take seconds for

Streamline Existing Processes and Procedures

1. Support public-private partnerships that produce results.
2. Improve export and import processing.
3. Bolster risk management programs.
4. Develop SPS standards that work for the region.
5. Integrate automated systems, including customs, immigration, warehouse and free zones.

integration of automated processes. Key benchmarks can be established, such as creation of a single export form or the removal of internal border crossings, as Guatemala and El Salvador have done at La Hachadura.

Reducing Delays and Costs: Streamlining Process and Procedures

While the customs union is being implemented, it is important to make processes as efficient as possible on the national level. Through regional cooperation and benchmarking, national reforms can be pursued that will later more easily integrate with regional measures. For example, a best practice in one country can be replicated in other countries and then made the customs union norm. Creating parallel and differing processes should be avoided.

Support Public-Private Partnerships that Produce Results

Although there are many steps that can be taken to improve efficiency, in most countries in the region procedural change is very slow, and a clearer process for accomplishing these priorities is necessary. One good way is to support existing public-private committees (also known as pro-committees) on trade modernization, which are often the best way to oversee and manage the process. These committees are producing tangible outcomes. (See text box, "Reducing Trade Costs through public-private participation.") Support from the highest level of government and the users of the trading system are essential to improve these trade processes, and should occur with structured, regional consultation.

Reducing Trade Costs through Public-Private Cooperation

Public-private partnerships play a critical role in trade facilitation. When trade-related public institutions work hand-in-hand with the users of the trading system, these partnerships lead to real results and significant trade transaction cost savings. Over the past year, USAID has been instrumental in helping to maximize the use of public-private partnerships known as "pro-committees," by creating them where they have not existed, reviving them where they have lapsed and supporting them where they already existed. Recent accomplishments of the committees include the following:

- The Guatemalan pro-committee, CONAFACIL, has started an initiative to tackle the cargo theft problem affecting trade in Guatemala.
- The Honduran pro-committee, CEIMSA, is working to fight corruption by reforming the customs personnel system.
- The Salvadoran pro-committee, CIMA, successfully petitioned for extended service hours from customs offices, banks and sea shipping offices.
- The Nicaraguan pro-committee, CIMCO, established consultation procedures between customs officials and truckers for after hours service and negotiated alternative truck routes for closed border crossings.
- In Costa Rica, where a pro-committee is being formed, public-private sector cooperation helped establish a "one-stop shop" (*ventanilla única*) to process all necessary documents at main border crossing with Nicaragua.
- Lastly, a regional pro-committee has been formed, COFACECA, and is developing a regional trade facilitation agenda.

Improve Export and Import Processing

Export processing should receive top priority. As noted in Section III, needlessly hindering exports is an all-too-common and imprudent path. Export functions should be quick, simple, and transparent. They should be automated, and the private sector should be allowed to participate in their operation. El Salvador's export processing office, CENTREX, provides a regional best practice that could be replicated in all Central American countries and be the model of a regional standard. CENTREX provides a completely automated export process with links to related public agencies and the trade community. (See text box, "Freeing Exports from Bureaucracy in El Salvador.")

Next, import processing should be streamlined to reduce requirements. A critical in-depth analysis of each step in the process needs to be documented and analyzed to determine its impact on the facilitation of international trade and whether it is in fact essential. The number of documents must be reduced and the requirement for signatures and stamps be eliminated. There is no current model in the region but a regional standard would clearly be the most efficient route. For example, issuance of blanket import health permits for a set time period or elimination of them altogether should become a possibility. Again, the trade community must be an essential player is this process.

Only when trade-related processes have been streamlined and simplified should steps be taken to incorporate electronic processing into the dynamic. Such automation, which is varied and even nonexistent in many countries presently, must link the trade community and customs processing system, so the trader can submit requests online and receive notifications electronically through a web-based application.

Bolster Risk Management Programs

Risk management should be the cornerstone of modernization efforts throughout the region. It is the foundation of a modern customs agency and modern management generally. Nonproductive physical examinations raise trade transaction costs and offer opportunities for corruption. A well-developed risk-management system provides the balance between customs' twin missions of facilitation and control. In fact, risk management

Freeing Exports from Bureaucracy in El Salvador

CENTREX is largely a positive model for El Salvador and the region. Its creation eliminated long, unnecessary delays of multiple visits to various agencies. The concept for CENTREX, a one-stop processing center for exports, was initiated in 1977 under the administration of the Ministry of Economy. However, it was not until it was transferred to the Central Bank in 1999 and additional features added, such as Internet access, linkage to the Customs processing system and now connection to the Guatemalan Customs system, that it evolved into a modern, cost effective, facilitative and efficient infrastructure for export processing. All exports, about 12,000 per month, are processed through this system. The only export permits required relate to processed food, agriculture and plant products. Highlights of the system include:

- CENTREX consolidates all necessary approvals among various agencies into one agency. For example, when exporting agricultural goods, CENTREX produces the required permit online.The system also controls quantity and company verification and authorization of merchandise subject to foreign quotas.
- CENTREX has a simple, straightforward interface. Any firm registered with the state as a legal export entity can open an account with CENTREX.The exporter then transmits the required data to CENTREX, which alerts the exporter to any other agency requirements.
- CENTREX has streamlined the time required for export review process from days to minutes. Response time from this agency is one to two minutes, making the total processing time less than five minutes. When completed, the transmission is electronically passed to Customs.
- CENTREX is an example of appropriate use of user fees. The system largely funds its own operations. Through a $4 processing fee, 70 percent of CENTREX's small staff (12 person) and reliable operations are

has the ability to transform the institution on a number of levels, particularly in the realignment and reapportionment of resources.

Risk management can significantly increase the efficiency and security of trade flows by allowing compliant users to use the system with fewer delays and by helping customs more accurately target illegitimate goods. It should decrease the overall number of inspections, thereby lowering the transaction cost of traders. Additionally, it should increase the incidence of identifying illegitimate trade, thus increasing revenues. These outcomes may increase the volume of exports and improve the overall environment for foreign investment.

Although most CAFTA countries have the customs risk-management function, its quality and sophistication varies. Often, agency or field personnel do little risk profiling and analysis, and poor automation within agencies hampers their ability to analyze examinations to determine compliance of the importers and exporters, even though this is at the very core of a risk- management system.

From an assistance perspective, a national approach to this critical function is necessary to address the current regional variation. However, it is important to aim for a goal of regional parity and to achieve regional efficiencies where possible. A few targeted programmatic interventions can assist the Government of El Salvador, including the short-term assistance such as (1) technology analysis, (2) economic sector analysis and training, and (3) audit training. USAID has developed an action plan to address this issue and a program is being implemented in each country.

Develop Sanitary and Phytosanitary and Health Standards that Work for the Region

SPS and food safety procedures have to be simplified to reduce costs and time to comply while maintaining sufficient controls to safeguard public health. Much can be done to facilitate the movement of products requiring SPS and food safety regulation through the harmonization of standards and procedures within the region. In some countries, 6 to 8 percent of a product's cost is attributable to compliance with the present procedures.

One key assistance program would be to reengineer the process. The reengineering process should include all agencies involved in regulation of the industry as well as the private sector. Much progress has been made in this sector on Central America products, and this same process must now be undergone in regard to other international goods. At a minimum this must include a decrease in the number of SPS documents that require a notary's authentication and a simplified process for low-risk goods. The rationalization of the current paper-based systems does not require major investment and can yield significant results.

A second key assistance program would be to implement the full range of Organismo Internacional Regional de Sanidad Agropecuaria ("OIRSA") services—collection of all fees, performance of all inspections, fumigation, lab analysis, and quarantine services—as the standard throughout Central America. These services are currently provided in Honduras and Guatemala, which have the most modern procedures, the best technically equipped and staffed laboratories, and the highest quality of inspection services in the region. This system works better because regional personnel are less subject to corruption by and collusion with the local trade, and accordingly increases revenue collection. OIRSA personnel, representing a regional body, can perform inspections for all regional goods in accordance with each country's requirements, even if not standardized. With improved access to collected user fees, agricultural ministries' will be able to modernize operations and eliminate costly requirements, such as posting inspectors at all posts throughout the region. If onerous registration requirements can be waived for Central American products, thought should be given to providing the same simplified procedure to like items from other nations and region, such as the United States and Europe, whose regulatory agencies are considered of high quality.

Further, development of agriculture standards must work in both directions—between Central America and the United States. CAFTA members would greatly benefit from a program that assists them with greater access to U.S. Department of Agriculture (USDA) information, as well as approval requirements and technical information

A Best Practice for the Region: OIRSA Border Services

OIRSA border services in Guatemala and Honduras provide professional, highly qualified inspectors, quality laboratories, and automated systems that serve to control work, expedite processing, and apply proper standards of risk analysis. In addition, OIRSA fee collection permits better, more expeditious access to funds by the Ministry of Agriculture.

In 2002, the Honduran government designated OIRSA as the provider of all agriculture and health border services. These services include complete responsibility for inspection, fumigation, quarantine, lab analysis and fee collection. (Guatemala has this same arrangement, while the other Central American countries utilize only limited OIRSA's services, such as fumigation and quarantine functions.) OIRSA inspectors work under requirements, laws and policies established by SENASA, or the *Servicío Nacional de Sanidad y Calidad Agroalimentaria,* which also resolves any problems that arise in the field. Both agencies participate in the recruitment and hiring of inspectors. Fees are established by Honduran law and are currently the third lowest in the region, behind Costa Rica and Guatemala. OIRSA collects all fees for inspections and import/export permits.

OIRSA's presence in Honduras has upgraded the quality of the country's SPS services, as evidenced by the following facts:

- OIRSA provides inspection personnel that are more technically proficient than other inspectors in the region, because OIRSA requires higher qualifications. They are also less susceptible to bribes because they receive higher pay.
- Regional inspectors provide a less politicized environment than those working for a national agency.
- OIRSA uses a high degree of sophisticated automated systems to control, record the process and provide updated information to the field offices. This increases speed, transparency and accuracy.
- OIRSA delivers results. In the years prior to using OIRSA inspectors, national inspectors identified 11 pests and plaques. Since OIRSA's installment in 2002, the number has risen to 3000.
- OIRSA laboratories are modern, well-equipped and well-staffed.
- Fieldwork is conducted thoroughly and efficiently. Pre- identification of problems is done on site. Fieldwork is automated and tracked, and inspectors have online research capability. Reports are prepared weekly, monthly and yearly on the quantity and quality of work, and are forwarded to SENASA, so it can maintain effective oversight.

on U.S. pharmaceutical products being introduced in their markets. It is critical to establish a regional coordination and information center, where all exporters and public SPS agencies can obtain information about U.S. import requirements and what the public agencies require in the way of technical assistance to meet these requirements. One suggestion would be to have OIRSA assume this responsibility. This center would have linkages to the United States to assist speedy resolution of issues. A web site should be established by the regional entity to disseminate information regionally on U.S. SPS requirements as updated criteria is received. This would be supplemented with seminars held throughout Central America by representatives of U.S. government agencies such as the USDA and its Animal and Plant Health Inspection Service (APHIS) and Food Safety and Inspection Service (FSIS), the Food and Drug Administration (FDA), and the Environmental Protection Agency (EPA), as well as U.S. import groups such as the grocers associations.

Integrate Automated Systems, including Customs, Immigration, Warehouse, and Free Zone Operations

The CAFTA countries should seek limited assistance in development of a program for modernizing links between customs agencies and free zones and warehouses. Warehouses and zones should all be linked to customs automation systems, and on-site customs supervision should be eliminated. To ensure cost-effective compliance, customs should adopt a post-audit approach to oversight. This is particularly pertinent to free zone operations that have little or no revenue impact. To promote a compliance ethic, operators should have the appropriate guarantees and be responsible for controlling movements in and out of the facility. Cost savings and improved resource allocation are significant with adoption of this approach. In addition, the certification of inventory control procedures and resulting post-audit approach will enhance customs controls over the operations.

Trade and Security: Enhancing the Security Environment

Establishing and maintaining secure trade is as important as efficient trade, especially in the post-September 11, 2001, environment. Security is high on the list of criteria for potential investors, and the costs of insecurity rests on the financial books of current regional traders. Improving current security conditions is essential and can result in significant savings in trade costs, as well as substantially enhance the attractiveness of the region for foreign direct investment. Although law enforcement is necessarily a national function, a regional focus and regional cooperation are essential.

Create Special Enforcement Units

In those nations where the security problem is particularly acute, the formation of special enforcement units is important. Special units have worked well in the region and around the world. For example, as recently as three years ago, Honduras suffered as many as 40 kidnappings in a year, mainly targeting domestic businesspersons near San Pedro Sula. In 2003, after the creation of a special antikidnapping unit, kidnappings were down to three, and there were no kidnappings through September 2004. The unit was specially formed, recruited, trained (by the FBI), monitored, and managed to handle these cases.

Enhance Trade Security

1. Create special enforcement units.
2. Join the Container Security Initiative.
3. Encourage a compliance ethic in the trade community.
4. Implement a government integrity program, specifically for trade-related institutions.

Programs should be tailored to address the specific security issues within the region. For example, an antismuggling and antifraud unit, using a combination of officers from customs and the national police, could be created. This staff would be carefully selected and subject to random drug and lie-detector testing. This unit would develop a threat assessment and action plan to combat smuggling, corruption, and fraud. Training in examination and interview techniques and the legal requirements for building a criminal case would be required. In addition, the team would be trained and equipped with specialized equipment. A vital link and partnership with the trade community would also have to be established to develop sources of information. In addition, as the creation of these special units would occur in parallel in each country, it would allow for them to be easily linked regionally.

Join the Container Security Initiative

The region's major ports should become members of the container security initiative (CSI). Membership in the CSI would expedite the release of shipments from the region on arrival in the United States, and would serve as a major selling point in the region's marketing strategy.

A program to help the major ports of the region join CSI would assist in this process. Most of the region's ports have made the International Ship and Port Security (ISPS) certification, which is an important step in upgrading and maintaining trade security. *Puerto Cortes* in Honduras, one of the two main regional ports (*Limón,* Costa Rica, being the second), is scheduled to obtain scanning equipment that meets CSI requirements. Once this equipment is operational, Honduras could join CSI, which would require the presence of a U.S. customs officer to review outbound manifests to the United States prior to export and cooperate with local customs officials to examine any suspicious shipments prior to loading.

Encourage an Ethic of Compliance in the Trade Community

A secure trading community is a compliant trading community. It is critical to create an ethic of compliance within the trade community. Structured reward programs, such as expedited processing, should be created to provide incentives for conforming traders. In addition to carrots, countries should also provide a stick by developing and providing greater support for criminal prosecution of parties involved in major trade violations. This can be done through regional training on trade norms for traders and public officials alike. Moreover, greater media coverage of customs and custom's role in trade facilitation would help create a stronger atmosphere of compliance.

Implement a Government Integrity Program specifically for Trade-related Institutions

Although improved compliance and interest of the trade community is important, government officials must also be encouraged to operate at the highest levels of integrity. Anticorruption efforts have been gaining ground in a number of countries in the region, most notably in El Salvador. In other countries, however, the trade-related agencies were cited as problematic. Corruption costs stifle entrepreneurship and innovation, and scare away new investment. Therefore, regionwide integrity program should be established for trade-related agencies, which includes strengthened and independent internal reviews as well as modern personnel systems. Personnel systems require clear candidate qualifications, improved recruitment procedures, and established, job-specific performance and evaluation standards.

Stronger Trade System: Upgrading and Maintaining Core Trade Infrastructure

Substantial savings in trade transaction costs can be achieved in intra- and extra-regional trade if the CAFTA countries create a seamless infrastructure environment. To do this, the countries must work together to lower transportation and infrastructure-related production costs. Regional initiatives are underway, with significant planning work prepared by the Secretariat for Central American Economic Integration (SIECA) and the Inter-American Development Bank's Plan Puebla y Panamá initiative, as well as logistics corridor studies prepared by member countries. Although these initiatives should be supported, it is most important that a service- and cost-based approach be deployed to target future infrastructure improvements. That is, future planning initiatives must focus on service reliability and cost reduction to system users to improve the region's competitive position. Although it is well known that broad improvements are needed, funding considerations and timing are critical to realizing positive changes in the near-term and long-term.

Coordinate Future Strategic Planning Efforts for a Regional Intermodal Transportation System

The Central American region requires a strategic approach to surface transportation infrastructure planning and implementation, i.e. a regional master plan. The system today, composed of roadways, railroads, airports, and seaports, is best described as a collection of independent components operating at widely varying levels of service and effectiveness. Overall, the system provides little to no seamless transfer of goods, which deeply affects service reliability, transit times, costs, and overall regional competitiveness.

Upgrade and Maintain Key Trade Infrastructure

1. Coordinate future strategic planning efforts for a regional intermodal transportation system.
2. Establish high-capacity roadway corridors.
3. Develop dedicated cargo handling facilities.
4. Expand airport services in strategic locations.
5. Improve regional electricity capacities.

The time is ripe to make strategic decisions regarding the future of the region's surface transportation infrastructure. Today's markets demand speed and efficiency in cargo handling, which requires purpose-built, dedicated cargo handling facilities and a quality transportation network. To that end, Central America's current surface transportation infrastructure must be evaluated against a set of common regional objectives and integrated into a unified system. To accomplish this, the following steps should be considered:

1) Identify future demand characteristics for surface transportation and future capacity needed to meet this demand at required levels of service (i.e., transit times, traffic density, security, etc.).

2) Develop a vision for the future surface transportation system including key transportation corridors, development of dedicated gateways (i.e., purpose-built seaport facilities), and efficient access to regional production/consumption zone.

3) Critically assess the ability of existing infrastructure to meet the established criteria, including a quantitative assessment of service and capacity shortfalls, and establish its role in the future vision.

4) Develop an executable surface transportation improvement plan that maximizes utility of existing assets, minimizes operating costs, and allows for predictable growth.

Efforts have been underway to develop such plans, for example, through the SIECA study, that identify critical roadway infrastructure improvements necessary to facilitate surface transportation in the region. This study, however, focuses on the north-south corridor of the Pan American Highway, favoring utilization and improvement of existing assets as investment imperatives. Trends in international trade demonstrate that the USEC is becoming the preferred international gateway for foreign goods, primarily because of service reliability and the potential for efficient consolidation and distribution of goods sourced from multiple points of origin. Consequently, the CAFTA region's Strategic Plan for a Regional Intermodal System must consider the predominant trends in international trade and prepare the region for "new thinking."

The CAFTA countries will require technical assistance in development of such a strategic plan. Initially, the program would involve a study of alternatives, evaluating the costs, operational benefits, and economic impact to the region. Further, the program would include establishing a platform for regional cooperation in trade infrastructure planning and resultant economic development. This regional cooperation is critical to achieve success. Individually, each of the CAFTA countries is too small and, in some ways, too disconnected from key gateways, to effectively implement and sustain a robust plan.

Facilitate Capacity Building Through Proof of Concept, Feasibility Studies, and Investment-Support Documentation

Evidence and proof that infrastructure investments will bring change and provide a positive return is a key stumbling block to realizing an effective trade infrastructure system in the CAFTA region. Infrastructure investors and donor agencies require proof that investments will provide a return. These studies differ from the strategic planning process identified above because they focus analysis on discrete investment projects that makes up part of the overall vision. USAID has the opportunity to help "make the money flow" from investors and donor agencies by supporting various investment studies, such as proof-of-concept studies, feasibility studies, and other investment support documentation. These documents are critical to investment and business decisions and are a necessary step to realization of improved infrastructure.

Establish High Capacity Roadway Corridors

The SIECA initiative to develop high capacity roadway corridors designed to modern specifications should be supported. Key transportation corridors requiring immediate upgrades should be identified and resources to implement the plan should be dedicated. This includes the current focus on the Pan-American Highway as well as a trans-isthmus corridor. Plans for bypass corridors around major population centers should be developed as well.

Develop Dedicated Cargo Handling Facilities for Seaports

Current seaports are generally classified as combination facilities that have been adapted to meet the initial needs of targeted customers. However, to provide high-quality service at costs attractive to ocean carriers, deployment of purpose-built facilities within the region is a must. Today, much of the cargo is considered transshipment cargo from the Panama Canal region, with little to no opportunities for direct call-liner services. Capital intensive, dedicated facilities, with the associated business development to support them, provide opportunities to serve a broader range of customers. In this regard, evaluation of potential service cost characteristics is critical to understanding the feasibility of capturing new business opportunities.

Expand Airport Services in Strategic Locations

Airport services throught the region are inconsistent and assistance is needed in the planning of key regional airport developments. New airport facilities are needed to serve the major commercial and governmental centers of Guatemala City, Guatemala, and Tegucigalpa, Honduras. The current facilities are reaching the limits of their service capacities across multiple dimensions. Assistance in planning how to replace these sites and planning for funding mechanisms would be important strategic assistance.

The Investment in Trade Facilitation: Improving Funding

Programs to reduce trade transaction costs are not without their own costs, and certain trade facilitation investments, namely infrastructure, are extraordinarily expensive. As noted, national budgets are tight and international assistance alone cannot provide for all the necessary trade facilitation reforms. However, there are smart ways to improve finances that will help fund a number of trade facilitation priorities.

Develop Revenue from Trade-related Service Fees that Fund High-quality Services

The most significant way to fund trade facilitation improvement is to provide trade-related institutions access to the revenue generated by existing service fees that fund high-quality services. Additionally, countries should develop and promote more World Trade Organization (WTO) compliant fees for services, such as for declaration processing, to augment budgets and generate funds to pay for these services. Service fees, where appropriate, help align services with costs and add to transparency and efficiency of processes. For example, El Salvador replaced an antiquated export processing system with its new, streamlined CENTREX system. With a low $4 processing fee, CENTREX funds 70 percent of its own operations. Traders are content to pay the fee because of their satisfaction with the service.

Improve Funding

1. Introduce trade-related service fees that fund high-quality services.
2. Develop regional competencies and cost-sharing for key trade functions.
3. End revenue quotas for trade-related agencies.

Build Regional Competencies and Cost-sharing for Key Trade Functions

Major cost efficiencies and savings can be achieved if cooperation can be marshaled to develop regional competencies. The current national funding for key trade-related institutions, which results in underfunded and poorly operated trade services, could be replaced by a regional focus. There is neither a means nor a rationale to fully fund five completely separate customs risk-management programs in a region where countries faces many of the same risks. One centrally shared development resource can much more inexpensively and effectively serve the region. The same shared resources in key areas, such as agriculture and health inspections, can result in better services at lower prices.

The savings and additional fees from these funding streams should be allocated to priority areas. These include payment of salaries, purchase of equipment and tools, modernization of customs and upgrading of facilities to help develop a process of electronic prearrival payment and release. Other key functions that could be regionalized include: risk management; laboratories for complex analysis; bilingual assistance help desks; web sites that identify all procedures that are necessary for clearance of customs, agriculture, health, and immigration requirements throughout the region; methodologies for express consignments; expertise in tariff classification and valuation; a standardized, binding advance rulings process; and commodity specializations which are empowered to operate throughout the region.

Improving Commercial Law and Institutions

There are vast advantages to doing business in a regional market that holds over 35 million people, rather than being confined to a national market of somewhere between 4 and 14.3 million people. A larger market means more customers, more opportunities, more competition, and more efficiency. But for these advantages to be realized, the commercial legal and institutional infrastructure throughout the region must be capable of functioning in a way that facilitates and encourages, rather than frustrates, regionally-oriented activity by individual entrepreneurs, SMEs, and large companies. Specific suggestions for reforms throughout the various aspects of the life a company are set forth below.

Establishing and Growing New Businesses: Help for SMEs

SMEs represent approximately 50 percent of the regional economy, yet, as previously discussed, most SMEs remain in the informal sector. Nearly $800 million has been committed to SMEs by the donor community. It is time for the governments of the CAFTA countries, along with the donor community, to take a comprehensive and coordinated approach to assisting SMEs. Cataloging, coordinating, and learning from the types of assistance that are available now will help end the haphazard way assistance is presently doled out—will leverage resources and will create a stronger environment for entrepreneurship and business growth in the future.

Establish a Regional Database of Loan Guarantee Programs

SMEs often depend on loan guarantees by a third party, especially when they are first-time borrowers or need financing for a startup company. Despite that programs exist to assist with this process throught the region, there is a lack of coordinated data to show development results. Current guarantee programs in the CAFTA region, however, particularly those funded by donors, are developing a valuable base of statistics and impact assessment information. It is not enough to use this information for tracking program success: it can also be used for planning for the evolution to the next phase of development and better loan guaraantee programs. Statistics should be developed for and within each guarantee program, and then compared and analyzed on a regional basis for all programs. Data should include:

- Results for each bank receiving guarantees, including:
  - Loans made
  - Jobs created (by type of loan; e.g., short-versus long-term)
  - Default rate
  - Reasons for default.
- Results for each guarantee program, including:
  - Total costs of the program
  - Costs per loan
  - Profit or loss if transformed to a for-profit program
  - Economic impact, including job growth, increases in exports, etc.

Within 3 to 4 years, this data will begin to tell a story that can be used for advocating appropriate next steps.

Create a Donor Network for SME Support

Clearly, the CAFTA region would strongly benefit from improved coordination of donor technical assistance, lending, loan guarantees, and other assistance for SMEs. One way this might be achieved is through the establishment of a regional, specialized SME development bank with preferential rates. A shorter term solution, and an especially urgent need, is the establishment of an SME support network, run by a board of directors consisting of both country and donor representatives. Such a network would: identify and catalogue all donor-funded resources for SMEs in the region; create a one-stop information source for SMEs seeking assistance (thus reducing time spent tracking down individual sources of funding and other support); establish a uniform application process for SMEs seeking assistance so that a single application could be submitted to all potential sources; create standard rules, rates, procedures, and resources; and establish training programs that could be presented on a regional basis.

Implement a program of SME advocacy and public awareness

Both borrowers and lenders are often unaware of SME support and loan guarantee programs that could benefit them, resulting in lost opportunities. At the same time, many of the existing and planned programs work with numerous stakeholders within their target markets and are uniquely qualified to conduct awareness campaigns. Moreover, numerous programs providing training and other assistance to SMEs are also uniquely situated to disseminate information to their stakeholders. Each program should therefore include public awareness and information dissemination as one of their tasks. To this end, there should be a process for tracking increases (if any) in the demand for or use of the assistance or guarantees by a program's targeted stakeholders.

SME support and loan guarantee programs must also take an active part in identifying and advocating reforms in the business environment. The programs act as an anesthetic to those who might not otherwise advocate change: with guarantees, banks do not have to worry about risks and borrowers get loans they could not otherwise afford, so neither has reason to complain. Once the guarantee programs are gone, however, the environment may be very much the same, unless the programs help to identify and address the problems that led to their creation in the first place. These programs are staffed by experts who understand what changes should be made to reduce the risks, but unless these individuals are required to focus on change, much of this expertise will be lost. Each program should therefore include an advocacy component, working with and through private sector and government counterparts to reduce risks through legal, educational, and other reforms.

Create a Regional Association of SME Support Agencies

There are individual government agencies in the CAFTA countries that are charged with supporting SMEs, but their mandates are weak. The leadership

Help Small and Medium Enterprises

1. Establish a regional database of loan guarantee programs, and channel lessons learned from various programs into a regional program for reform.
2. Create an SME Support Network of donor assistance programs, creating a one-stop information source for SMEs seeking support and providing an opportunity to standardize procedures.
3. Within all SME support projects, include a program of SME advocacy and public awareness.
4. Create a regional association of national SME support agencies.
5. Bring consistency and accountability to the process of market entry throughout the region, including consistency in certification, licensing, and inspection.
6. Once consistency among company registration procedures is established, create a regional electronic company registry.
7. Enact measures to facilitate the authentication of documents, including a regional convention that allows companies that are registered in one country to be legally recognized in all countries, without significant additional administrative steps.
8. To improve access to capital, all countries should enact the OAS Model Inter-American Law on Secured Transactions and educate stake-holding communities in its content and implementation.

of these agencies should be challenged to come together to bolster the collective influence of their organizations throughout the region. Such a regional association could serve numerous purposes, from information sharing to resource pooling to standardization of procedures. In particular, the association could share best practices pertaining to the following types of SME support:

- Information on the legal and regulatory environment tailored to the type of business being considered (for example, registration, licenses, or labor law),
- Information and guidance on access to finance,
- Grants or other low-cost finance for disadvantaged groups,
- Guidance on marketing and information sources available for their planned business,
- Counseling on the decision of when and how to form the business,
- Referral to specific skill training that might be necessary before a business can be launched,
- Financing, and
- Support to develop basic business management skills through training (finance, marketing, accounting, administration, etc.).

Should some CAFTA countries prove more effective in providing the types of support listed above, the less effective countries can benefit from their experiences. A regional association could also influence guiding national legislatures that are seeking to improve the environment for entrepreneurship and business growth in their respective countries. A regional association of SME support agencies would be an important source of information pertaining to best practices, regional solutions, and legal harmonization initiatives.

Ease Access to Donor Assistance to Bring Consistency and Accountability to the Process of Market Entry throughout the Region

There is an enormous need for a regional initiative that identifies and assists in the removal of redundant and overlapping requirements placed by states upon businesses attempting to register and enter the marketplace. With financial and technical assistance from the donor community, the CAFTA countries should collectively first catalogue and then bring regional consistency, to the following:

- Legal authority for registrations, certifications, licensing, and inspections, including the company registration process,
- Standards of compliance for applicants,
- Standards of conduct for officials,
- For inspections, limitations on inspection authority, such as:
  - Permissible frequency of inspection
  - Scope of inspection, and
  - Maximum duration of inspection,
- Schedules of fees, charges, and penalties, and
- Process for complaints and appeals.

Although only national bodies can remove or change national requirements, these national institutions require clear direction concerning how they might harmonize their market entry procedures with those of the other countries. Compilation of this information on a regional basis would give national governments guidance with respect to how they are to manage regulatory harmonization.

Enact Measures to Facilitate Authentication of Documents

As detailed in several of the country reports, authentication of documents can be a crucial issue for companies trying to do business in their neighboring states. The procedures for recognizing the authenticity of business contracts, documents evidencing property ownership, or registration of collateral often prove unclear or inconsistently administered, thus increasing transaction costs. In more than one CAFTA country, foreigners have complained that a document notarized abroad, such as a power of attorney, is not valid without passing through the lengthy procedure of legalization.

Even thereafter, the document needs to be locally notarized. CAFTA countries have taken very few steps toward the recognition and authentication of electronic documents and signatures. The following solutions would address these issues:

- Enact a regional convention to provide for recognition of contracts that have been notarized in one country as valid in all countries, without significant additional administrative steps.
- Adopt the following in all CAFTA countries:
  - The Inter-American Convention on Legal Regime of Powers to be Used Abroad
  - The Inter-American Rules on Electronic Documents and Signatures (IAREDS)
  - The Hague Convention Abolishing the Requirement of Legalization of Foreign Public Documents.
- Develop training (that can be administered both in person and online) for lawyers, notaries, judges, and others about the parameters of the regional and international agreements pertaining to authentication of documents.

Rekindle Efforts to Create a Viable Regional Stock Market

With respect to the ability of businesses to raise money through the sale of stock, two primary suggestions have emerged: (1) harmonization of stock market and exchange laws within the CAFTA region and (2) development of a regional private sector working group focusing on a long-range goal of establishing a regional stock market. In fact, a Central American stock market exists, but is so weak that few people or enterprises make use of it. A regional approach should evaluate the desirability of either concentrated reform of the existing institution or its elimination, followed by a fresh start. With a more highly developed stock market system, businesses will have a greater opportunity for growth and will therefore be not only be more attractive, but also more accessible to foreign investment. It is unlikely that the present disparate, small, and weak markets in the region could serve as an engine for growth. Moreover, efforts to develop such markets without harmonization will not serve long-term interests given the imperative of regionalism.

Harnessing the Power of Property

Establish a Regional Strategy for Real Property Reform

Although the problems run deep, efforts to improve the means of tracking property value and ownership must continue, and a new emphasis on consistency in cadastral and real property registry systems throughout the region is warranted. Specifically, an effort should be made to make laws and regulations pertaining to property both simpler and more consistent throughout the region. National bodies charged with overseeing property registration should develop processes for acting in a coordinated fashion, reviewing regional best practices for collateral laws and registry operations. A long-term automation strategy should be developed, one that includes, as a precursor to automation, improved business processes, procedures, and workflows. A vital long-term goal would be that of using technology to facilitate sharing of information of the registries within the region to ease research and investigation of encumbrances.

In addition, there currently is virtually no collaboration among the property and collateral registries in the CAFTA countries. For example, mechanisms for ensuring that property has not been used in two countries to secure a loan are not yet in place. Procedures for registration vary significantly from state to state. The information-sharing potential of technology has not been tapped. A long-term goal for the region should be shared registries for collateral and property that can be accessed over the Internet.

Meaningful collaboration would contribute to greater security among lenders. Regular interaction between the registries would encourage examination of best practices, harmonization of procedures, and initiatives that encourage integration of information resources would all serve to benefit the environment for accessing capital.

Lastly, it should be noted that while the poor state of the land cadastres is a central concern in most countries, modernization of cadastres tends to be prohibitively expensive for donors and local

Harness the Power of Property

1. Create and implement a long-term plan for improving the regulatory infrastructure that supports real property in the region, including (a) promoting simplification and consistency of procedures among the cadastres and real property registries; (b) improving institutional management and automation; and (c) enabling information-sharing among cadastres and registries.
2. Monitor the impact of and lessons learned from the recent implementation of World bank's PATH project (Land Administration Project of Honduras) and the *Ley de Propiedades* in Honduras, using these reforms as a regional model.
3. To strengthen property rights in the region, all countries should enact the OAS Model Inter-American Law on Secured Transactions.
4. Create a regional strategy, one that involves business organizations and professional associations, for improving the use of remittances in the development of the property market.

government budgets. Cadastre information is not routinely updated; the information is not linked with that contained in the real property registries; and cadastres have little to no automation. This confused state of affairs hinders the ability of individuals and businesses to use their land as security for loans.

Facilitating the Use of Movable and Intangible Property as Assets through Legislation

The Model Inter-American Law on Secured Transactions was drafted with the active participation of the leading specialists in the Americas and approved by the OAS in 2002.[25] An appendix to this Model Law, called the Inter-American Rules on Electronic Documents and Signatures (IAREDS), was also approved and recommended for adoption. The enactment of the OAS Model Law in CAFTA countries, together with IAREDS and with the modernization of land registries, would make it possible to extend commercial and construction credit throughout the region at rates of interest approximating those of Canada and the United States and using more than real property as collateral. Properly implemented, this modernization and harmonization would result in the creation of an active regional and international credit market for the CAFTA region's SMEs and build trade capacity throughout the Americas. Of course, proper implementation is a multifaceted challenge that includes: the education of judges, practitioners, and executive branch officials who are responsible for implementation; public education and outreach; and monitoring and evaluation of progress, with opportunity to share best practices and lessons learned among each of the participating countries.

Channeling Remittances to Achieve Property Ownership

The CAFTA countries would benefit from a joint strategy to harness remittances more efficiently, allowing them to be used as a powerful tool in the property market. Specifically, an effort to encourage Central Americans living in the United States to invest directly in local property, rather than through middlemen, would reduce transaction costs and fees, and allow more of the money to be used for actual investment in real property. In addition, business organizations and professional associations should attempt to promote the services of Central American brokers for transactions in Central America. Finally, the same organizations should endeavor to enable real estate sales searches over the Internet, so that they are accessible to expatriate Central Americans.

Complying with Standards of Corporate Governance

The assessment process determined that concerns pertaining to corporate governance do not resonate deeply in Central America for a number of reasons, including, for example, the significant portion of businesses working in the informal economy and the number of companies that are operated by families or are otherwise closely held. Moreover, Central America lags conspicuously behind other nations in Latin America in the area of corporate governance awareness and reform, as evidenced by the fact that no CAFTA country currently participates in the Latin American Roundtable on Corporate Governance, established by the OECD in 2000. The Roundtable represents an important regional initiative to build awareness and facilitate public and private sector policy dialogue. It provides a forum for the exchange of experiences between senior policymakers, regulators, and market participants with first-hand experience of present developments and ongoing work. To keep pace with their neighbors in the region, CAFTA countries should seek the right to participate.

The issue of corporate governance and its bearing on regional development could fill a separate report, and the needs in the CAFTA region are great. The CAFTA countries should begin to tackle these issues through careful analysis of the OECD's White Paper on Corporate Governance in Latin America (2003), including, where applicable, implementation of the White Paper's reform priorities and recommendations. The issues that reformers in the area of corporate governance can expect to confront include the rights and treatment of shareholders and other company stakeholders, disclosure of company information and transparency in management practices, and board-member responsibilities.

As the economies of the region continue to grow, engagement of international expectations of corporate governance are a crucial part of efforts to attract and maintain businesses in the region. International businesses seeking to invest in the region will be less likely to do so if potential local partners do not practice at least minimal standards of corporate governance.

Establish and Enforce Standards of Corporate Governance

1. Join the OECD's Latin American Roundtable on Corporate Governance to ensure exposure to best practices in the region and beyond.
2. Develop understanding and adopt the recommendations of the OECD's White Paper on Corporate Governance in Latin America. In particular, this will force the CAFTA countries to confront issues of disclosure of company information, transparency of management practices and board of director responsibilities, and treatment of (in particular minority) shareholders.

Regionalizing Competition Law and Policy

As detailed earlier, considerable effort is needed to promote a well-functioning competition policy in each of the CAFTA countries. These efforts would be more effective and significantly easier if a regional strategy toward capacity building was adopted. With a view toward regional convergence, national lawmakers should carefully consider the competition laws of Costa Rica, Mexico, and Panama, and drafting committees in Guatemala, Honduras, and Nicaragua should make efforts to communicate with one another and prepare drafts that are regionally consistent. In particular, they should consider the substantive legal provisions for anticompetitive agreements and practices found in the Costa Rican and Mexican laws. In countries with especially weak judiciaries, they should also consider institutional models that include specialized tribunals.

Using the efforts of the *Dirección General de Competencia y Transparencia de Mercados* in Nicaragua and the early experiences of the *Comisión de Promoción de la Competencia* in Costa Rica, policymakers and donors should work together to conduct competition advocacy, outreach, and education with legislatures, business organizations, and legal practitioners. This recommendation is particularly relevant for El Salvador, in building support for its new law and implementing agency, and for Guatemala and Honduras, in garnering backing for passage of the laws.

For a comprehensive competition policy framework, Guatemala, Honduras, and Nicaragua will need to adopt national competition laws. El Salvador should work at designing a well-functioning agency and educating staff. Costa Rica would benefit from the development of merger guidelines and information regarding the treatment of confidential information for the private sector.

Using Andean Community competition policy and regional capacity-building programs as a guide, policymakers and donors should develop regional programs that address educating relevant stakeholders, capacity building for new agency staff, and basic enforcement challenges of new agencies. Given the success of the Association of Southeast Asian Nations (ASEAN) competition policy

Improve Competition Law and Policy

1. Develop a program for competition advocacy, outreach, and education, targeting legislatures, business organizations, and legal practitioners.
2. Ensure that competition law drafting committees in Guatemala, Honduras, and Nicaragua communicate with one another and prepare drafts that are regionally consistent.
3. Support newly-established competition enforcement agencies – in El Salvador and in the other countries as laws are enacted. This should encompass short and long-term technical assistance, resident advisors and mentoring, training curriculum development and execution, public information programs, and assistance in sharing information with sister competition agencies in other CAFTA countries. Failure to provide the newly-established implementing agencies with sufficient resources will undermine their ability to establish credibility and garner public support from the outset.
4. Make competition laws and policies a part of any over-arching Commercial Law curriculum that is developed for judges and lawyers. Like other commercial law topics, a substantial foundation must be provided, preferably through a certificate-granting program of no fewer than 40 hours of training time, with an anonymously graded exam at the end.

program, consideration should be given to making the Andean model more robust by adding a regional long-term advisor to the program.

Bolstering Capabilities for Contract Enforcement

Establish an Effective Regional Body for Resolution of Commercial Disputes

The crisis in contract enforcement calls for numerous institutional changes in individual countries, as detailed in the country reports. In addition, during the country assessments, a significant amount of interest was expressed in the development of a regional institution for managing contract disputes and other commercial litigation. The idea would be for commercial litigants to escape the administrative limitations and substantive prejudices of national courts.

Many ideas exist for the possible structure of such a body. In one approach, it could be a forum for alternative dispute resolution of commercial matters involving businesses from different countries. In another approach it could act as a regional court having officially sanctioned appellate powers over commercial disputes between different countries. Each of these ideas involves sacrificing national authority for the regional betterment—a proposition that bears some risk but also warrants consideration. There is a strong case for the establishment now of a regional working group to investigate the development of a regional commercial court or other body where commercial disputes can be addressed. One important source of guidance would be the lessons learned from the work and outreach efforts undertaken by NAFTA's Advisory Committee on Private Commercial Disputes.

A regional approach to resolving disputes may be a catalyst to re-energize efforts to promote ADR. Working in cooperation with judges, lawyers, and professional associations, donors should encourage programs that focus on improving understanding and use of commercial arbitration and mediation.

Create a Mentor Judge Program

There are good judges in Central America, but there is not, unfortunately, a tradition of judicial independence. Nor is there a tradition within the judicial profession of developing special expertise in commercial law, just as some judges may become experts in the criminal law or human rights arena. Judicial mentoring is one way to develop the skills and professional confidence of judges. Mentoring "provides a constructive forum for exchanging ideas, sharing potential approaches and solutions to issues, and obtaining constructive feedback on work performance from a neutral evaluator."[26] With respect specifically to the judicial profession, "the mentor can educate the mentee about the nature of court activities and the work of judges, as well as traditions, values, customs, policies, and procedures that go along with the profession of judging."[27]

Several examples from recent USAID experience reinforce the conclusion that, when judges from outside the region build trust over time with their counterparts in developing countries, the sense of professional confidence and judicial competence among the counterparts improves substantially, thus contributing to a stronger system of justice.[28] A regional mentoring program that brings Spanish-speaking judges into the courtroom to observe and provide feedback to their peers may prove enormously beneficial. Targeting such a program to address matters of commercial law and, in particular, the role of judges in implementing the commercial law would represent an important initiative in commercial legal and institutional assistance.

Develop Regional Standards for Professionalism: A Code of Conduct Initiative

Although there is no shortage in the CAFTA region of trained, competent professionals, it is clear that, in general, individuals in positions of authority should work to meet higher standards. Professionals from all dimensions of the judicial and trade communities must be encouraged to see their work as not simply a series of procedures to follow, but as an opportunity to solve problems, serve the public, and make a difference. Through strengthened professional organizations, improved access to and quality of continuing education, collective development of codes of conduct, and increased public understanding of what they are entitled to expect, individuals in positions of authority can be encouraged to do better. Similarly, in the private sector, successful business leaders should be challenged to set an example for improved systems of corporate governance, through better accounting practices, more efforts at transparency, and stronger protections of minority shareholders.

Several regionwide organizations currently exist that are likely resources for improved professional development. These include the *Instituto Centroamericano de Administración Pública (ICAP); the Centro Internacional par el Desarrollo Humano Sostenible* (International Center for Sustainable Human Development); and an organization of notaries. The establishment of new regional organizations should also be explored, in particular a regional judge's association. The first agenda item for each of these regional professional organizations should necessarily be to establish a professional code of conduct or to review an existing code for soundness and sufficiency. The next step would be to undertake an information campaign both within the profession and beyond about what the public is entitled to expect of its professionals and what professionals must demand of themselves. The benefits of sustained regional consultation among professional peers—whether they are judges, lawyers, accountants, customs or immigration officers, or other officials—cannot be understated.

Create an Environment for Better Contract Enforcement, Better Judges and Better Lawyers

1. Establish an effective regional body for resolution of commercial disputes.
2. Create a program for mentoring of judges with shared expertise both within and outside the region.
3. Develop a regional program for standards of professionalism for judges, lawyers, accountants, Customs and Immigration officers. Each of these professions should collaborate to develop a Code of Conduct. Professional training based on these codes should be implemented throughout the region.
4. Develop a certificate-granting, regional continuing legal education program for commercial lawyers. The certificate that is granted upon completion of each course would distinguish lawyers who have completed the program as especially competent and up-to-date in the topic that is covered. Also, to underscore the importance of mastering the topic, an anonymously graded exam as a condition to pass the courses should be required.
5. Develop a region-wide program to improve legal education in commercial law topics.

Develop a Certificate-Granting, Regional Continuing Legal Education Program for Commercial Lawyers

Experience elsewhere shows that mandatory training and continuing legal education (CLE) requirements are necessary to ensure demand for training services. For example, most states in the United States require lawyers to attend a certain number of CLE courses to maintain their licenses. Lawyers generally prefer this mandatory system to a voluntary one: they do not find the time to take such courses unless they are forced to. Likewise, many professional associations require education for initial certification and ongoing licensing.

To the extent that the legislative or professional environments in the region do not appear to support the institution of mandatory CLE, a regionally accredited commercial law certification program may serve to improve the knowledge base of lawyers. As confirmed in each of the country reports, there is a compelling need for lawyers in Central America to significantly improve their knowledge base and skills; a common refrain among individuals interviewed for the assessments was the need for a more and better CLE for lawyers who work with commercial law. But it is not enough to offer occasional seminars on an *ad hoc* basis for a few hours or even a full day. Rather, for certain topics, no fewer than 40 hours of training is the minimum background that would qualify a lawyer who expects to practice in a certain field (such as bankruptcy, competition, or property).

The construction of a sustained, substantive, and comprehensive regional training program for practitioners in commercial law would be an enormous undertaking. Such a program would require coordination and consensus between the major donor and local actors. That said, the establishment of a certificate-granting, regional commercial law institute, through which lawyers may subscribe to a respected program that will prepare them to work in the new economic environment, is worth significant consideration. A sample curriculum would include the following courses:

- Introduction to Contemporary Practices of Commercial Law (40 hours)
- Drafting for Commercial Lawyers: Correspondence, Contracts, and Cases (40 hours)
- Lawyering for Companies and Investors (40 hours, including 15 hours devoted to corporate governance)
- Collateral Law: The Creation and Enforcement of Pledges (40 hours)
- Property Law in CAFTA Countries (40 hours)
- Intellectual Property Law (40 hours)
- Bankruptcy Law (40 hours)
- Competition Law (40 hours)
- Public Procurement (40 hours)

Ideally, each course would be offered two or three times a year, commensurate with demand. The certificate granted upon completion of each course would distinguish lawyers who have completed the program as especially competent and up-to-date in the field. Also, to underscore the importance of mastering the topic, an anonymously graded exam as a condition to pass the course would be desirable.

Improve Legal Education

The state of legal education in the CAFTA countries—though not without strengths—is a significant problem. Through a regional approach to improving legal education, there are several ideas worth exploring. Existing organizations that promote regional cooperation among universities and professional schools should be evaluated for their effectiveness and, where sound, supported in efforts to do more. Sister school relationships between CAFTA-region law schools and U.S. law schools should be developed and refined. Cross-border training and complementary curricula should be established. In addition, donors should support the establishment of a regional legal studies center that focuses on trade and commercial environment issues within CAFTA and the larger North American–Central American region.

Leadership among both local institutions and the donor community is vital. Donors and local stakeholders must come together to develop a strategic, coordinated approach to commercial legal education in the region. Leadership is needed especially with respect to curriculum development in the major regional law schools. To establish a baseline for reform, the following questions need clear answers:

- What commercial law and trade-related courses are currently available in the standard law school curriculum? Who are the faculty members teaching these courses and to what extent are these faculty members themselves familiar with recent changes in the law?
- What is the universe of local and donor activity specifically targeted at the law schools? Of this activity, which specifically pertains to commercial law and trade? What is the current level of donor coordination with respect to commercial law-related assistance to the law schools?
- What long-term reforms are necessary to allow the law schools to provide a comprehensive and meaningful curriculum in commercial law and trade? How can these reforms be prioritized? What existing structures are in place within the legal education community to oversee and guide a long-term reform process, and what new structures might be necessary?
- What short-term methods could be used to get much-needed information and assistance to students now? How could donor and local resources be leveraged to most effectively implement these methods?

In reality, reforms to the legal education system throughout Central America will likely take a generation. Through a shared regional vision of long-term reform, combined with thoughtful and well-executed short-term initiatives, however, a shift in the learning dynamic and the quality of commercial legal education may take place in a sustained and meaningful fashion.

Implement a Regional Bar Exam in Commercial Law and Practice

Although the absence of national bar exams throughout CAFTA countries reflects national tradition and may or may not be an imperative for reform, the development of an optional regional bar exam may improve perceptions over the ability of lawyers to facilitate deal-making across borders. Strong consideration should be given to an exam and certification process that focuses on international and regional institutions, company law, secured transactions and property law, contract law and enforcement, financial crimes and international trade may serve in effect to develop a core expertise. The very development of such an exam would force the leading legal minds of each country to arrive at certain core principles that their best commercial lawyers would then be encouraged to master. Passage of such an exam and regional certification of lawyers would give both domestic and foreign investors greater confidence in the soundness of the deals they make.

Improving Restructuring and Liquidations

As detailed earlier in this report, there is, for all intents and purposes, no effective bankruptcy regime in Central America. Building such a regime would require essentially starting from "square one," and a regional process of doing so represents the most efficient and effective way to do so. On a regional basis, a program to support bankruptcy reform would entail a series of components.

Use Country Report Findings as Baseline for a Bankruptcy Reform Initiative

Perhaps for the first time, the state of the bankruptcy systems in the five CAFTA countries has been detailed according to their legal framework, implementing institutions, supporting institutions, and social dynamics. This baseline data is the first step toward establishing a comprehensive program for regional bankruptcy reform. Each national government should appoint a special representative for bankruptcy reform, who can then commune on a regular for the purpose of building consensus and developing a regional program for reform.

Develop a Model Bankruptcy Curriculum to be shared among Law Schools and Training Institutions in the Region

Law school curricula must be completely updated and expanded to ensure that future lawyers graduate with the necessary basic understanding of bankruptcy regimes. In addition, professional

Establish a Bankruptcy Tradition

1. Use Country Report findings as baseline for a regional bankruptcy reform initiative. Each national government should appoint a special representative for bankruptcy reform, who can then commune on a regular basis for the purpose of building consensus and developing a regional program for reform.
2. Develop a model bankruptcy curriculum to be shared among law schools and training institutions in the region.
3. Engage in a public education program. First, a national, popular campaign is needed to change basic popular mis-understanding about the nature of bankruptcy. Second, targeted education is needed for government officials, union leaders, consumer organizations, and others to address their fears regarding misuse of bankruptcy and misconceptions of "inappropriate" debt.

associations and training institutes need practical handbooks and training materials for continuing legal education in this field. To the extent CLE in bankruptcy is not being developed under current projects, additional assistance should be provided to ensure that bankruptcy reforms are accompanied by a complete set of curriculum and training materials, and that trainers are trained to continue providing services.

Whatever the education or training vehicle, it is enormously important that the information imparted to law students, lawyers, judges, and others be consistent and correct. Thus, a regionally developed model curricula would be an important aspect of educating professionals in the region about the fundamental concepts underlying bankruptcy. Thereafter, individual institutions could tailor their curricula to incorporate national laws, norms, and requirements.

Engage in Public Education

Popular understanding of bankruptcy is almost universally poor. Bankruptcy is often viewed as a moral failure, a form of theft, a sin or weakness of character that unfairly allows the guilty to go unpunished. Although bankruptcy can be misused—especially in underdeveloped legal systems—these attitudes overshadow the positive use of bankruptcy for settling claims, releasing productive assets, restructuring businesses into viable activity, and forgiving debts on a reasonable basis. Consequently, it is difficult to garner support for bankruptcy reforms or to get SMEs to turn to bankruptcy courts for help before they become insolvent.

Public education is needed at several levels to address these issues. First, a national, popular campaign is needed to change basic popular understanding. Second, targeted education is needed for government officials, union leaders, consumer organizations, and others to address their reasonable fears regarding misuse of bankruptcy and misconceptions of "inappropriate" debt forgiveness. Such an initiative is essential as well for reforming the overall regime to ensure that inappropriate behavior is in fact properly sanctioned. New materials should also be introduced in appropriate business education courses.

Facing up to the Realities of Corruption

Despite widespread and well-known analyses of the situation as well as specific efforts—with some successes, it should be noted—the individual country reports confirm that a persistent lack of confidence in the integrity and effectiveness of trade systems and the commercial law environment throughout the CAFTA countries continues to antagonize economic progress in the region. In short, although it is difficult to measure, it is clear that corruption, within both commercial law and trade-related institutions, and in both the public and private sectors, continues to affect the ability of the CAFTA nations to move forward, singularly or as a region.

In each of the five countries, the reform of corruption was said to be on the government's agenda, but definitive results and a collective will to disarm the problem almost always failed to meet the goals. These finding match Transparency International's 2004 Corruption Perception Index (CPI), which surveyed 146 countries (see figure IV-1).

The presence of Costa Rica and El Salvador in or

Figure IV-1

Country	World Ranking	CPI score[30]
Costa Rica	41	4.9
El Salvador	51 (three-way tie)	4.2
Nicaragua	97 (five-way tie)	2.7
Honduras	114 (nine-way tie)	2.3
Guatemala	122 (seven-way tie)	2.2

Source: Transparency International

near the top third of countries rated is positive, but the scores themselves reveal that a great deal of improvement remains to be made. The relatively poor showings of the other countries means that enormous efforts must be made if these countries are ever to fully realize the promise of regional economic development.

What will it take for the five CAFTA nations to implement effective institutional reforms that actually work to stop corruption and ameliorate its far-reaching effects? As prior reports have shown, solutions are available, and some are not even especially complicated.[29] More significant, political will must be garnered to implement such solutions. Although in the past national wills have failed, it is now time for the region to act. On the positive side, by concluding the CAFTA agreement itself, the CAFTA countries have demonstrated political will. This, however, is only a first step.

Steps to Ending Corruption

There is a strong case for creating and bolstering not only country-specific programs that target corruption, but also a regionwide anticorruption initiative. A regional program would send a message to outsiders, especially those who are inclined to think of CAFTA as a single market, that the problem is being taken seriously, and that each of the five countries will even forgo issues of national pride and autonomy to both talk about corruption and confront it in all its forms. Although efforts at a national level have embraced some of the strategies below, they have met with only halting progress[31]; accordingly, a regional approach will create new vigor and greater accountability for such efforts. Ideas for region-wide initiatives include:

- Generally, work with public and private leadership throughout the region to study the relationship between the institutions affected by corruption (agencies, registries, courts, andother public institutions) and the motives and opportunities for corruption and to develop a detailed regional plan for addressing the corruption. That plan should *include the adoption of best business and administrative processes as identified by regional organizations and by world efforts to understand and combat corruption.* For example, develop a regionwide media program that encourages responsible public discussion about corruption.
- Establish among professional groups codes of conduct that are created through a deliberative and consultative process and ensure that these codes are shared with consumers of the public services; develop mechanisms to enforce such standards.
- Develop a regionwide system of financial disclosure and other conflict-of-interest disclosure, which *includes public disclosure*, for executive officials and judges.
- Embark on a meaningful and effective program to protect the security of higher-level decisionmakers, including judges, who may succumb to corrupt practices due ultimately to fear over their personal and professional security.
- Increase the perceived formality of certain administrative positions and processes, through such means as identification badges, uniforms, and prominently posted information concerning fees, schedules, appeals, and dispute resolution mechanisms, as well as greater use of automated systems that encourage accountability and reduce opportunities for corruption.[32]

Because of the nature of corrupt practices, it is difficult to assess the true negative values of corruption. In the absence of continued reforms in the area of corruption, however, the entire CAFTA region will continue to suffer from a lack of public confidence, from both within and beyond its borders. Business and investor interest and capabilities will erode, and much of the costs will be passed along to the region's consumers, most of whom already being unable to afford them.

V. Conclusion

In following a growing trend with respect to regional trade agreements, Central Americans are taking part of the "new-wave" of regional integration efforts a their commitment to increasing international trade on a broader scale rather than trying to control it within the region.[33] In fact, as shown by many of the participants in the assessment process, CAFTA is viewed as more than a trade agreement: it also a new path for development and reform and a means of integration and harmonization on a regional level—concepts that until now have remained for the most part aspirations.

As this report describes, much work is needed to move the CAFTA countries along their new path. This effort will not be possible without making difficult choices from scarce resources, but such choices can and must be made through carefully prioritized strategies and focused execution. Some of the work will have to be undertaken at a national level. As many of the countries in the region face common challenges, however, regional approaches to solving these problems will often provide the most efficient way to make progress. By addressing the challenges described herein through the reform strategies, the CAFTA countries will be better positioned to achieve the ultimate goal for the region: long-term economic growth, poverty reduction, and sustainable development.

Appendix A: Recommendations Chart

I. Improving Regional Trade Facilitation

Supporting the Customs Union

No.	Recommendation
1.	Assist the union in creating key streamlined procedures, including those involving export, import, sanitary, phytosanitary, and immigration.
2.	Support regional automated connections so that systems talk to each other.
3.	Aid the union in developing proper security controls. (i.e., regional risk management systems and regional security cooperation initiatives).

Streamlining Process and ProceduresTrade and Security: Enhancing the Security Environment

No.	Recommendation
1.	While the Customs Union is being implemented, in the interim it is important to make processes as efficient as possible on the national level. Export processing procedures should be streamlined following the model of CENTREX in El Salvador, which provides a completely automated the export process with links to the pertinent public agencies and the trade community.
2.	Through a public-private partnership, a critical in-depth analysis of each step regarding import processing in each country needs to be documented and then analyzed to determine which processes are essential and the impacts each has on the facilitation of international trade. As a result of this effort: a. The number of documents must be reduced and the requirement for signatures and stamps be eliminated. b. Issuance of blanket import health permits for a period of time or elimination of them altogether should become a possibility. While this must occur on a national level, each country should cooperate in these efforts so that when regional processes are to be adopted the differences will not be as great.
3.	After processes have been streamlined, they should be more highly automated, and such efforts at automation should link the trade community directly to the relevant government agencies.
4.	Stronger risk management programs are is required in areas such as high-risk commodities and high-risk traders or filers. Moreover, consistent practices for container examinations should be adopted throughout the region.
5.	Warehouses and free trade zones should all be linked to customs automation systems and on-site customs supervision should be eliminated.
6.	SPS and health requirements, standards, and procedures should be developed on a regional basis in order to ensure consistent and less onerous requirements. a. SPS and food safety procedures have to be simplified to reduce costs and time to comply while maintaining sufficient controls to safeguard public health. c. CAFTA countries should also work with the U.S. to develop standards and requirements that facilitates trade in goods regulated by SPS and health standards, from Central America to the US and the reverse.
7.	The CAFTA countries must developed a regional coordination and information center that will be able to directly interact with relevant U.S. agencies, such as the Department of Agriculture as well as to provide traders with up-to-date requirements.
8.	As a part of Customs Union implementation, a regional transit module should be created that includes a simplification of documentation, including elimination of the Customs declaration for Central America or the transit declaration, as well as improved and ongoing training for shippers on new technology and security concerns.

Trade and Security

No.	Recommendation
1.	Anti-smuggling and fraud units, using a combination of officers from Customs and the National Police could be created to address security issues. Such units would develop a threat assessment and corresponding action plan to combat smuggling, corruption and fraud.
2.	The region's major ports, Cortes and Limon, should become members of the container security initiative (CSI).
3.	Improve investigations and prosecutions, require training as to trade norms for both traders and officials, and encourage greater media coverage of trade issues in order to encourage and ethic of compliance in the trading community.
4.	To improve government performance with respect to trade matters, an ethics and integrity program should be implemented for trade-related agencies which includes strengthened and independent internal review, as well as improve the personnel information gathering and decision-making process, first on a national level and then from a regional perspective as the Customs Union becomes stronger.

Stronger Trade System: Upgrading and Maintaining Infrastructure

No.	Recommendation
1.	Identify future demand characteristics for surface transportation and future capacity needed to meet this demand at required levels of service (i.e., transit times, traffic density, security, etc.).
2.	Develop a vision for the future surface transportation system including key transportation corridors, development of dedicated gateways (i.e., purpose-built seaport facilities), and efficient access to regional production/consumption zone.
3.	Critically assess the ability of existing infrastructure to meet the established criteria, including a quantitative assessment of service and capacity shortfalls, and establish its role in the future vision.
4.	Develop an executable surface transportation improvement plan that maximizes utility of existing assets, minimizes operating costs, and allows for predictable growth.
5.	With respect to roadways: 1) Support should be given SIECA initiatives to develop high-capacity roadway corridors designed to modern standards. 2) A regional basis, prioritize identify key transportation corridors requiring immediate upgrades, and dedicate resources to implement a plan for the upgrades, including the Pan-American highway as well as trans-isthmus corridors. 3) Develop plans for bypass corridors around major population centers.
6.	Develop dedicated cargo handling facilities for seaports in region, as most are currently combination facilities servicing a wide array of shipment types. In order to provide high quality service at costs attractive to ocean carriers, deployment of purpose-built facilities within the region is a must.
7.	Improve airport services, including capacity of shipments and passenger handling in Guatemala City and Tegucigalpa.
8.	Support ongoing regional initiatives to improve electricity transmission capacity across the region.
9.	Efforts should be made to recalibrate the charging and collection of telephone fees across the region, for all levels of calls (local, regional, extra-regional) as currently there is no ability to recover call termination costs.

Making the Investment in Trade Facilitation: Improving Funding

No.	Recommendation
1.	Trade-related institutions must be granted greater access to the revenue generated by current service fees in order to alleviate budget constraints and work toward reform. For example, countries should develop and promote WTO compliant User/Service Fee for such services as declaration processing to augment budgets and generate funds to pay for these services. Where there are no user fees currently in force, introduce trade-related service fees that fund high-quality services.
2.	The current national funding for key trade-related institutions, which results in under-funded and poorly operated trade services, should be replaced by a regionally focused institutions which would achieve major cost efficiencies and savings.
3.	End revenue quotas for trade-related agencies.

II. Improving Commercial Law and Institutions

Establishing and Growing New Businesses: Help for SMEs

No.	Recommendation
1.	Establish a regional database of loan guarantee programs, and channel lessons learned from various programs into a regional program for reform.
2.	Create an SME support network of donor assistance programs, creating a one-stop information source for SMEs seeking support and providing an opportunity to standardize procedures.
3.	Within all SME support projects, implement a program of SME advocacy and public awareness.
4.	Create a regional association of national SME support agencies.
5.	Bring consistency and accountability to the process of market entry throughout the region, including consistency in certification, licensing, and inspection.
6.	Once consistency among company registration procedures is established, create a regional electronic company registry.
7.	Enact measures to facilitate the authentication of documents, including a regional convention that allows companies that are registered in one country to be legally recognized in all countries, without significant additional administrative steps.
8.	To improve access to capital, all countries should enact the OAS Model Inter-American Law on Secured Transactions and educate stake-holding communities in its content and implementation.

Facilitating Authentication of Documents

No.	Recommendation
1.	A regional convention should provide for the recognition of contracts that have been notarized in one country as valid in all countries
2.	If they have not done so already , all CAFTA countries should adopt the following: a. the Inter-American Convention on Legal Regime of Powers to be Used Abroad; b. the Inter-American Rules on Electronic Documents and Signatures (IAREDS); c. the Hague Convention Abolishing the Requirement of Legalization of Foreign Public Documents.
3.	Education of lawyers, notaries, judges, and others about the parameters of the regional and international agreements pertaining to authentication of documents is a prerequisite for their effective enforcement.

Rekindle Efforts to Create a Viable Regional Stock Market

No.	Recommendation
1.	Development of an inter-regional private sector working group focusing on a long-range goal of re-establishing a regional stock market.
2.	Harmonize stock market/exchange laws within the CAFTA region.

Harnessing the Power of Property

No.	Recommendation
1.	Create and implement a long-term plan for improving the regulatory infrastructure that supports real property in the region, including (a) promoting simplification and consistency of procedures among the cadastres and real property registries, (b) improving institutional management and automation, and (c) enabling information-sharing among cadastres and registries.
2.	Monitor the impact of and lessons learned from the recent implementation of the World Bank's property initiatives and the Ley de Propiedad in Honduras, using these reforms as a regional model.
3.	To strengthen property rights Movable and Intangible Property as Assets in the region, all countries should enact the OAS Model Inter-American Law on Secured Transactions. Create and implement a regional plan for improving the regulatory infrastructure that supports secured transactions, including (a) promoting simplification and consistency of procedures among collateral registries; (b) improving institutional management and automation; and (c) enabling information-sharing among collateral registries.
4.	Create a regional strategy, one that involves business organizations and professional associations, for improving the use of remittances in the development of the property market.

Establish and Enforce Standards of Corporate Governance

No	Recommendation
1.	Join the OECD's Latin American Roundtable on Corporate Governance to ensure exposure to best practices in the region and beyond.
2.	Develop understanding and adopt the recommendations of the OECD's White Paper on Corporate Governance in Latin America. In particular, this will force the CAFTA countries to confront issues of disclosure of company information, transparency of management practices and board of director responsibilities, and treatment of (in particular minority) shareholders.

Regionalizing Competition Law and Policy

No.	Recommendation
1.	Develop a program for competition advocacy, outreach, and education, targeting legislatures, business organizations, and legal practitioners.
2.	Competition law drafting committees in Guatemala, Honduras, and Nicaragua should make efforts to communicate with one another and prepare drafts that are regionally consistent.
3.	Support for a newly established competition enforcement agencies—in El Salvador and in the other countries as laws are enacted—should encompass short- and long-term technical assistance, resident advisors and mentoring, training curriculum development and execution, public information programs, and assistance in sharing information with sister competition agencies in other CAFTA countries. Failure to provide the newly established implementing agencies with sufficient resources will undermine their ability to establish credibility and garner public support.

4.	Competition should be a part of any overarching commercial law curriculum that is developed for judges and lawyers. As with other commercial law topics, a substantial foundation must be provided, preferably through a certificate-granting program of no fewer than 40 hours of training and with an anonymously graded exam at the end.
5.	The law and economics faculties the universities in the region should be included in substantive discussions and curriculum development efforts pertaining to competition law so that students may be sufficiently prepared in this area.

Contract Enforcement

No.	Recommendation
1.	Establish an effective regional body for resolution of commercial disputes. Establish a long-term plan for the development of a regional body that resolves contract disputes and handles other commercial litigation, either through ADR or formal judicial procedures.
2.	Create a program for mentoring judges with shared expertise both within and outside the region.
3.	Develop a regional program for standards of professionalism for judges, lawyers, notaries, accountants, customs, and immigration officers. Each of these professions should collaborate to develop a code of conduct. Professional training based on these codes should be implemented throughout the region.
4.	Develop a certificate-granting, regional continuing legal education program for commercial lawyers. The certificate that is granted upon completion of each course would distinguish lawyers who have completed the program as especially competent and up-to-date in the topic that is covered. Also, to underscore the importance of mastering the topic, an anonymously graded exam as a condition to pass the courses should be required.
5.	Develop a regionwide program to improve legal education in commercial law topics.
6.	Implement a regional bar exam in commercial law topics.

Restructuring and Liquidations

No.	Recommendation
1.	Use country report findings as baseline for a regional bankruptcy reform initiative. Each national government should appoint a special representative for bankruptcy reform, who will then regularly communicate with counterparts, building consensus and developing a regional program for reform.
2.	Develop a model bankruptcy curriculum to be shared among law schools and training institutions in the region.
3.	Engage in a public education program. First, a national, popular campaign is needed to change basic popular understanding about the nature of bankruptcy. Second, targeted education is needed for government officials, union leaders, consumer organizations, and others to address their fears regarding misuse of bankruptcy and misconceptions of "inappropriate" debt.

Appendix B: Country Report Background and Methodology

The CAFTA Trade and Commercial Law Activity Assessment Process

During negotiations of the Central American Free Trade Agreement (CAFTA), a committee was formed between the Trade Capacity Building (TCB) representatives from each of the Central American countries and the U.S. government—through the United States Trade Representative and later the U.S. Agency for International Development (USAID). One of the main priorities identified by this committee was the need for a regional assessment that would identify key priorities that would help CAFTA member countries take better advantage of the free trade agreement. The goal of these assessments was to gain a snapshot of the current state of two critical areas—trade facilitation and the commercial legal and institutional environment. Most important, the assessments would make recommendations that help focus strategic planning for relevant USAID missions, the countries themselves, and other donors, so that programmatic resources could be better allocated to appropriately prioritized needs. Accordingly, countries in the region would be better positioned to seize their opportunities. To complete this effort, at the request of USAID, Booz Allen Hamilton (Booz Allen) undertook the Trade and Commercial Law Assessment Activity (the TCLA) for the Central American Countries party to the CAFTA.

The foundation of the TCLA is the Commercial Law and Institutional Reform (CLIR) methodology (previously developed by USAID with the assistance of Booz Allen), and TradeStream™ (a Booz Allen-developed diagnostic tool focused on trade facilitation issues). The TCLA was administered on the national level for five Central American countries, and the results of the individual national assessments are available separately.[34] The report identifies the major regional issues and approaches to best assist the CAFTA countries with the challenges and opportunities they have. Progress depends on action on both the national and regional levels.

The assessment process was carried out through much of 2004 in each of the CAFTA countries by a team of experts in trade and commercial law. To gain

Table B-1. Members of the Team and Areas of Specialization

Name	Organization	Subject area focus*
Aimee Carter, Team Leader	Booz Allen, International Development Specialist	CLIR
Andrew Mayock, Co-team Leader, TradeStream™	Booz Allen, Legal Reform Specialist	Flows of People and Money, TradeStream™
James Newton, Assessment Coordinator	Booz Allen, Legal Reform Specialist	Commercial Dispute Resolution (CDR), Financial Crimes, other CLIR areas
John Corley	Booz Allen Hamilton, Engineer	Infrastructure
John Baker	Louisiana State University, Commercial Law Specialist	CDR, Financial Crimes, Competition
JoAnne Cornelison	Independent Customs Consultant	Flows of Goods and Services
Maria Coppola	Federal Trade Commission, Legal Reform Specialist	Competition
Dale Furnish, Boris Kozolchyk, Maria Alejandra Rodriguez, Mariana Silveira	National Law Center for Interamerican Free Trade, Legal Reform Specialists	International Trade, Bankruptcy, Collateral
Omar Garcia	BG Consulting, Legal Reform Specialist	Property, Contracts, Company Law
Irina Swift	Independent Customs Consultant	Flow of Goods and Services

* Given the extended nature of the assessment process, team members served as backups for each other because not all experts were able to participate in each country.

the highest quality information possible, the CLIR portion of the CAFTA TCLA also employed teams of local experts in each country, which included lawyers, judges, government officials, and business leaders, to assist in the collection of data. The process began in March with a methodology seminar where local experts from the region were introduced to the CLIR methodology. Following this process, the local experts performed the base assessment for the CLIR portion of the analysis. With the completion of the base assessment, the team used this information as well as their own research to discern particular areas of focus prior to arrival in each country.

While in each country, the team interviewed numerous government officials, nongovernmental organizations, multilateral and bilateral donor agencies, judges, lawyers, notaries, investors, associations and chambers of numerous industries, trade and customs experts, and other domestic and international businesspeople to assess the trade and commercial legal environment of the each country.

Background of the Diagnostic Methodology Used

These assessments were the next in a series carried out since 1998 in a program that USAID created, and in which Booz Allen was retained to assist in the development of indicators and methodologies, for assessing the status of CLIR in a developing or transitioning country. In addition, more recently, the need for the development of a similar methodology to assess trade matters was recognized, which Booz Allen completed (TradeStream™) and which is applied here for the first time. Although the CLIR and TradeStream™ diagnostics can be considered as two separate parts, together they make up a more complete picture of a nation's overall situation with respect to domestic and international business.

Both the CLIR and Tradestream™ methodologies have been subjected to field-testing and peer review on a regular basis. Moreover, they have been adapted to the exigencies and realities of the area of the world in which they are to be applied; in the case of the TCLA, the CLIR methodology was adopted to better fit the Central American legal context, as opposed to that of Eastern Europe, for example, where the methodology was originally applied.

In addition, new areas of law continue to be added to the methodology. Along with the first application of TradeStream™, TCLA saw the further development and application of the newest CLIR section, Financial Crimes, which focuses primarily on those issues surrounding terrorist financing and money laundering, and have become more relevant in the wake of September 11, 2001.

Scope of the Methodology

The diagnostic assessment was designed to help USAID missions, the countries themselves, and other donors achieve the following objectives:

- To provide a factual basis for characterizing the degree of development and the status of trade commercial law reforms in a country
- To provide a methodologically consistent foundation for identifying and describing the root causes of the "implementation/ enforcement" gap among the CAFTA countries
- To provide analytical and planning tools and metrics to design new approaches to sustainable, cost-effective interventions and reform programs.

Although the subject matter areas have varied from country to country, for the purposes the assessments in question, they include the following areas:

- **Bankruptcy**. Mechanisms intended to facilitate orderly market exit, liquidation of outstanding financial claims on assets, and rehabilitation of insolvent debtors
- **Collateral**. Laws, procedures, and institutions designed to facilitate commerce by promoting transparency, predictability, and simplicity in creating, identifying, and extinguishing security interests in assets
- **Commercial Dispute Resolution.** Laws, procedures, and institutions relating to the settlement of commercial disputes, whether through courts or alternative dispute resolution mechanisms, and the enforcement of judgments and decrees

- **Company Law.** Legal regimes for market entry and operation that define norms for organization of formal commercial activities conducted by two or more individuals
- **Competition**. Rules, policies, and supporting institutions intended to help promote and protect open, fair, and economically efficient competition in the market, and for the market
- **Contract**. The legal regime and institutional framework for the creation, interpretation, and enforcement of commercial obligations between one or more parties.
- **Financial Crimes**. The legal regime, institutional infrastructure, and methods of international cooperation employed to prevent the financing of terrorist activities and laundering of criminal assets.
- **Real Property.** The laws, procedures, and institutions responsible for establishing, maintaining, and preserving rights in real property, including land, buildings, easements, liens, and other interests in real property
- **International Trade.** The laws, procedures, and institutions governing cross-border sale of goods and services.

With respect to the Tradestream™ diagnostic, the areas of inquiry are as follows:

- **Flows of Goods and Services.** Analyzes a nation's ability to move goods and services smoothly through ports of entry and throughout the country.
- **Flows of Money and Flows of People.** Assesses a nation's ability to facilitate the entry and exit of financing and business persons there for short- and long-term business dealings. This is similar to Goods and Services.
- **Supporting Infrastructure.** Assesses the capacities of a country's physical infrastructure relevant to trade, including seaports, airports, roads, railways, communications, and postal services.

Within each of these substantive areas, four dimensions of CLIR were examined as a conceptual framework for comparison. These include the following:

1. **Framework Laws.** Basic legal documents that define and regulate the substantive rights, duties, and obligations of affected parties and provide the organizational mandate for implementing institutions (e.g., Law on Bankruptcy, Law on Collateral)
2. **Implementing Institutions.** Governmental, quasi-governmental, or private institutions in which primary legal mandate to implement, administer, interpret, or enforce framework laws is vested (e.g., bankruptcy court, collateral registry)
3. **Supporting Institutions.** Governmental, quasi-governmental, or private institutions that either support or facilitate the implementation, administration, interpretation, or enforcement of framework laws (e.g., bankruptcy trustees, notaries)
4. **Social Dynamic/Market for Reform.** The interplay of stakeholder interests within a given society, jurisdiction, or group that, in aggregate, exert an influence over the substance, pace, or direction of commercial law reform.

Appendix C: Central America's Economic Profile

Macroeconomic Environment

The benefits of regional integration can only be understood in the context of an understanding of the current macroeconomic situation in the individual countries. Regional cooperation offers significant promise for economic growth and development in the region. However, it is important to gain an understanding of just how extensive the challenges are within the individual countries and the hurdles facing the process of regional integration.

As a whole, the economies of the CAFTA countries in the past years can be characterized as being relatively stable, with moderate growth, and with low external debt, except for Nicaragua, which continues to have one of the world's highest foreign debt burdens. However, further scrutiny yields a more comprehensive understanding of how different the economies of these countries are and the substantial economic differences among them (see Table C-1).

Like much of Latin America, income inequality is high. Also, like Latin America, while the countries in the region have many similarities, they also have many differences.

Poverty

Of the five CAFTA countries, Nicaragua and Honduras are two of the poorest countries in the Western Hemisphere, with large portions of their populations living in poverty (see Table C-2). Fortunately, the economic situation is not universally bleak throughout the entire region. Costa Rica, which has been successful in attracting a disproportionate share of inward investment, has a population that enjoys a relatively high standard of living, with the highest per capita income in the region, but Costa Rica's relative wealth has often served to divide, rather than unite the region with respect to political and economic initiatives.

Table C-2. Poverty in Central America (percentages)

Country	Population living in poverty	Population living in extreme poverty
Guatemala	69	42
El Salvador	56	23
Honduras	79	54
Nicaragua	72	41
Costa Rica	23	8

Source: Economic Commission for Latin America and Caribbean (ECLAC)

Trading Partners for the CAFTA Countries

The CAFTA countries include economies with very distinct levels of linkage to each other, from those for whom Central America holds a strong economic importance as the source and destination of their foreign trade, to others for whom the rest of the region is almost inconsequential. For example, approximately 66 percent of El Salvador's exports and 50 percent of its imports are with the United States. For Guatemala, 60 percent of exports and approximately 33 percent of imports are with the

Table C-1. Basic Economic Indicators

	Costa Rica	El Salvador	Guatemala	Honduras	Nicaragua
Population	3,896,092	6,470,379	13,909,384	6,669,789	5,128,517
Per Capita GDP (Purchasing Power Parity)	$8,500	$4,700	$3,700	$2,600	$2,500
Area (km^2)	51,100	20,749	108,889	112,088	130,700
Literacy Rate (%)	93	78	60	73	74
Life Expectancy (Years)	76	68	65	68	66

United States. Nicaragua's trade with the United States is less significant, with approximately one-third of its exports and 25 percent of its imports with the United States. In each of these examples, trade flows with neighboring countries have been minimal and hold significant room for expansions to the benefit of the region as a whole.

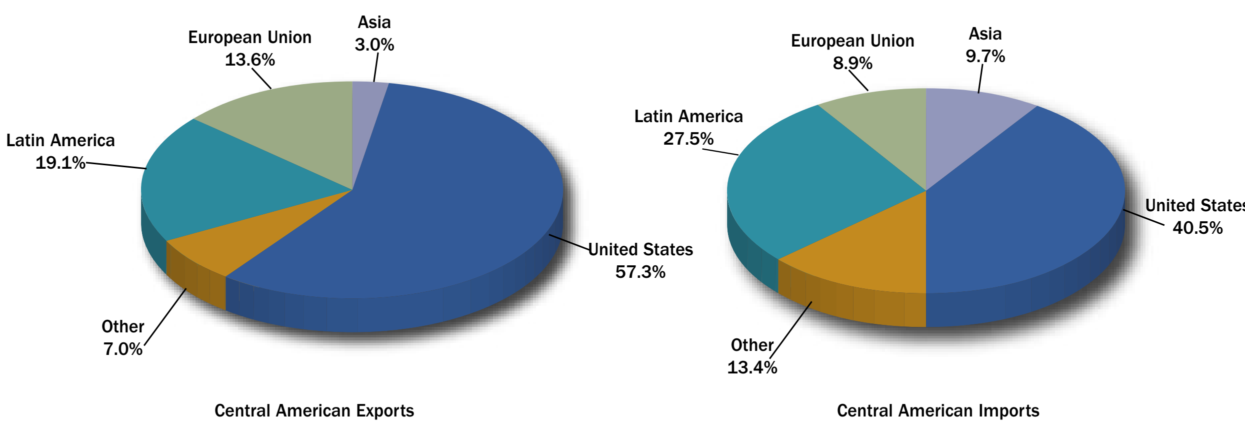
The close economic linkages that already exist between the CAFTA countries and the United States explain why these countries have suffered from the effects of the slowdown in the U.S. economy that began in late 2000 and which became more pronounced in the aftermath of the events of September 2001 can be summed up in Figure C-1, which graphically illustrates the preponderance of Central America's trade with the U.S. market.

Growth, Fiscal Policy, and Inflation

The close linkages to the U.S. economy present not only benefits but also perils. Given the extensive dependence on the U.S. economy, the prospects for increased growth in the region will largely depend on whether the recent improvement in the U.S. economy continues. Growth trends have paralleled those in the United States, as can be seen from Table C-3, and the absence of economic diversification suggests that this will continue to be the case in the future. When economic performance in the United States has been strong, the CAFTA countries have also done well. As U.S. performance lagged after the booming 1990s, the CAFTA economies also lagged.

Maintaining fiscal discipline in the face of this slower growth has been difficult, with the consequence that some fiscal deficits have worsened in recent years in some of the countries of the region. Governments have been taking measures to address these trends. As illustrated in Table C-4, Nicaragua, for example, has nonetheless been able to reduce its debt. The situation in Costa Rica is related to its having implemented a consolidated fiscal deficit that surpassed 5 percent of gross domestic product (GDP). The central government deficit grew by 1.4 percent to 4.3 percent of GDP.

Figure C-1. Central America's Direction of Merchandise Trade (2002)



Source: Congressional Research Service.

Concerns about inflation in the region have reemerged, largely because of the significant increase of international oil prices in the past months. As

Table C-3. GDP Growth Rates, 1991–2004 (percentages)

	1991–2000	1991–1995	1996–2000	2001–2003	2001	2002	2003	2004[35]
Costa Rica	5.2	5.5	4.9	3.1	1.0	2.9	5.6	4.5
El Salvador	4.6	6.2	3.1	1.9	1.8	2.1	2.0	2.5
Guatemala	4.1	4.3	4.0	2.2	2.2	2.2	2.1	3.0
Honduras	3.2	3.5	2.9	2.8	2.6	2.7	3.2	3.5
Nicaragua	3.2	1.5	5.0	2.0	3.1	1.0	2.3	4.0

Source: InterAmerican Development Bank

Table C-4. Fiscal deficits and public debt 2000-2003 (percentage of GDP)

	Fiscal Deficit				External debt	Domestic debt
	2000	2001	2002	2003	2003	2003
Costa Rica	3.0	2.9	4.3	2.8	21.1	33.4
El Salvador	2.3	3.6	3.1	2.1	30.0	12.3
Guatemala	1.8	1.9	1.0	2.3	13.9	8.0
Honduras	5.8	6.0	5.2	5.5	66.4	5.7
Nicaragua	8.7	12.8	8.6	6.7	85.9	36.2

Source: InterAmerican Development Bank

Table C-5. Rates of Inflation

	Costa Rica	El Salvador	Guatemala	Honduras	Nicaragua
1991-1995	19.4	12.9	14.9	20.9	601.4
1996-2000	12.7	3.9	7.6	16.1	11.1
2000	11.0	4.3	6.0	11.1	9.8
2001	11.3	1.4	7.3	9.7	4.7
2002	9.7	2.8	6.3	7.3	6.0

Source: ECLAC

prices stabilize, inflation worries may dissipate. Table C-5 presents historical inflation rates for the region.

Productive Sectors

Traditionally, Central American countries have been reliant on agricultural exports including coffee, sugar and bananas. Exports of these products have generated a large portion of their GDP. However, the similarity of production resulted in a primarily competitive relationship among these countries as opposed to a collaborative one based on complementarities of production. Moreover, such products have struggled in the international marketplace—for a variety of reasons including natural disasters—leading to a greater level of poverty.

Over the past 10 years, economic reform efforts have led to the development of new sectors intended to diversify their economies' dependence away from traditional commodities. Non-traditional exports have been developed and there has been a growth of maquila industries (assembly of products, mainly textiles and apparel, for reexport). This transition has been particularly evident in El Salvador, where, in 2003, only 3.4 percent of the country's export earnings came from coffee, compared to more than half in 1988. Although most Central American countries have made great strides to diversify, agriculture still plays a vital role in their economies.

The agricultural sector constitutes approximately 15–20 percent of the regional GDP, 40 percent of the regional labor force, and 25–30 percent of total regional exports. Although natural resources constitute one of the main bases for development, rural poverty and environmental and land degradation are characteristic of the region.

The Impact of Foreign Direct Investment

The United Nations (UN) Economic Commission for Latin America and the Caribbean published *Foreign Investment in Latin America and the Caribbean, 2003* Report, in which it pointed out that foreign direct investment (FDI) in Central America and the Caribbean fell in 2003 compared to peak levels of the past. Central America received $1.742 billion in 2002. In addition, remittances from Central Americans working abroad have increasingly contributed to the region's economies and are estimated to amount to well over $6 billion for the CAFTA countries and increased by 20 percent from 2002 to 2003. Approximately one in four inhabitants of Central America receive remittances.

Most notable in its success with attracting FDI was Costa Rica. According the UN Economic Commission, "In less than 20 years, it changed its natural resource-based export basket (bananas and coffee) to move toward high technology manufactured exports. As a result of its policy of attracting quality FDI, high technology exports went from 3.3 percent to 28.1 percent of total exports from 1995 to 2001."[36] In place of traditional industries, Costa Rica has been able to attract private investment, including large companies like Intel Corporation and Proctor and Gamble.

Costa Rica's success in attracting FDI—which has set it apart from the other CAFTA countries—has been a significant motivating force for regional agreements. Other CAFTA countries have come to more fully appreciate the value of FDI for economic growth and development and hope to leverage the CAFTA to attract more FDI to their economies.

Exports

As seen in Table C-6, it is only with the emergence of stability in the region in the 1990s that the CAFTA countries have started to see a growth of both their imports and exports. During the 1980s, trade was essentially stagnant.

There has been a significant transformation of the structure of exports since the early 1990s with export growth concentrated on a number of nontraditional products. As a result, the share of traditional commodity exports (bananas, coffee, sugar, cotton, and meat) has decreased in the 1990s in all countries with the exception of Guatemala. For example, Costa Rica's agricultural exports fell from 68 percent of total exports of goods in 1995 to only 31 percent in 1999. In the 1990s, new export crops have been developed, especially fruits and vegetables, ornamental plants, and new agricultural staples. Some light manufactures have also been added to the export basket, with electronics manufacturing the most notable in Costa Rica.

In addition, Central America has emerged as a significant assembler of garments (and, marginally, of other manufactured goods, such as plastic goods, metal products, and consumer electronics) for the U.S. market. Honduras is the largest contributor in this regard, with almost 100,000 jobs generated in Export Processing Zones by foreign firms and their domestic subcontractors.

The direction of trade is predominantly outward looking, with only 20 percent of the Central American Common Market's (CACM) exports being exchanged intra-regionally (see Tables C-7 and C-8). The share of intra-regional exports has slightly increased over the 1990s (from 16 percent in 1990 to a peak of 22 percent in 1994, down to 20 percent in 1999). The decrease in the share of intra-regional exports in the latter half of the 1990s was in favor of exports to the United States, which account for 49 percent of all exports from CACM countries.

The main exporting country in the region is Guatemala, representing 34 percent of CACM's exports in 1999. Other major exporters of the region are Costa Rica and El Salvador. In 1999, Costa Rica was the only country that held a trade surplus, originating from its $277 million surplus with other CACM countries, while Guatemala held the highest trade deficit, at $2.1 billion in 1999. Costa Rica is the least integrated of the five member countries, with only 9 percent of its exports destined to the region, compared to 32 percent in the case of Guatemala and 54 percent in the case of El Salvador.

Imports

Only approximately 13 percent of all imports originate from other CACM countries. Imports from the United States have increased markedly in the last decade, owing to assembly operations throughout Central America.

Table C-6. Exports and Imports of the Central American Common Market (CACM) Countries (Millions of Dollars)

	1980	1990	1995	1996	1997	1998	1999	2000	2001
Exports (f.o.b.)	4768	4354	8284	8568	10005	11499	11945	11846	10613
Imports(c.i.f.)	6001	6473	12817	13110	15355	17994	18432	19601	20743

Source: United Nations Conference on Trade and Development, UNCTAD Handbook Of Statistics, 2002.

Table C-7 Matrix of CACM intra-regional exports and to the world in 1999 (US$ millions)

Importing Countries / **Exporting Countries**

	Costa Rica	El Salvador	Guatemala	Honduras	Nicaragua	CACM	World
Costa Rica		116	179	103	179	577	6,283
El Salvador	92		272	172	91	627	1,164
Guatemala	121	356		209	104	790	2,458
Honduras	6	77	59		10	152	761
Nicaragua	27	68	15	34		144	509
CACM	246	617	525	518	384	2290	11,175

Source: Inter-American Development Bank (IDB) Instituto para la Integración de América Latina y el Caribe (INTAL)

Table C-8 Matrix of CACM intra-regional imports and from the world in 1999 (US$ millions)

Importing Countries / **Exporting Countries**

	Costa Rica	El Salvador	Guatemala	Honduras	Nicaragua	CACM	World
Costa Rica		100	142	30	28	300	5,987
El Salvador	116		369	88	65	638	3,129
Guatemala	141	257		79	7	484	4,554
Honduras	54	161	203		14	434	2,654
Nicaragua	208	100	134	78		520	1,722
CACM	519	618	848	275	114	2,374	18,046

Source: Inter-American Development Bank (IDB) Instituto para la Integración de América Latina y el Caribe (INTAL)

Excluding *maquila* trade, import patterns throughout the region have remained relatively stable throughout the 1990s. Imports in the region are diversified and include consumer goods, and a variety of intermediate and capital goods that have fueled the economic diversification away from agriculture. Still, there are sizeable imports of agricultural inputs such as bulk wheat and yellow corn. Crude petroleum and mineral fuels account for other major inputs, as do other chemicals, including a wide range of items such as medicinal and pharmaceutical products and plastics.

Nicaragua's imports include many identical consumer and capital goods, but also reflect significant expansion in the mining, manufacturing, and construction sectors, with increased imports of manufactures—chemicals, semi-manufactures, and machinery.

Endnotes

[1] The assessments were conducted between May and September 2004 and can be downloaded in both English and Spanish from http://www.bizlawreform.com.

[2] *See, e.g.*, IMF Working Paper, *How Much Do Trading Partners Matter for Economic Growth?,* Vivek Arora and Athanasios Vamvakidis, February 2004.

[3] For purposes of this report only, references to "the CAFTA countries," "the CAFTA region," or any similar reference, unless otherwise indicated, refers to the Central American CAFTA nations, i.e., Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua. This is for ease of reference only and not meant to discount the remaining trading partner in CAFTA, i.e., the United States.

[4] www.cia.gov/cia/publications/factbook.

[5] The assessments were performed in the following order: May 2004—Costa Rica; June 2004—Guatemala; July 2004—El Salvador; August 2004—Nicaragua; September 2004—Honduras.

[6] This theory was first expounded by David Ricardo in the early 19th century and underpins the reason why nations trade.

[7] There is a growing body of evidence that demonstrates the linkages between trade policy liberalization, economic growth, and poverty reduction and lays to rest the notion that trade liberalization is only an end in itself. For example, in his recent book, *Trade Policy and Global Poverty*, William Cline concludes that global free trade would elevate developing countries' GDP by 5.5 percent after 10–20 years if protection against imports from developing countries were eliminated. Furthermore, such liberalization would reduce world poverty by 20 percent—bringing more than 500 million people above the poverty line, defined as earnings of $2 per day. Cline estimates that approximately half of the benefit would accrue from liberalization of trade in agricultural products and that, although much of the gain for developing countries comes from liberalization by developed countries, there is also significant gain from intra-developing country liberalization. William R. Cline, *Trade Policy and Global Poverty*, Center for Global Development, Institute for International Economics, Washington, DC. (2004).

[8] Daniel Lederman, William F. Maloney, and Luis Serven, *Lessons from NAFTA for Latin America and the Caribbean: Summary of Research Findings*, The World Bank (2003) (http://lnweb18.worldbank.org/LAC/LAC.nsf/ECADocByUnid/Opendocument).

[9] *World Bank Global Economic Prospects 2005, Trade, Regionalism, and Development*, Chapter 4, "Beyond Trade Policy Barriers: Lowering Trade Costs Together," page 80.

[10] *World Bank Global Economic Prospects 2005, Trade, Regionalism, and Development*, "Overview," page xi.

[11] Except for NAFTA, most of the free trade agreements, negotiated by the United States (with Singapore, Jordan, and Chile) have not been in existence long enough to provide a comprehensive assessment of their impact. Even the full story of NAFTA has yet to be told, given that many of its tariff liberalizations have yet to be fully implemented. Nonetheless, even the interim assessments of other regional accords offer ample reasons to be optimistic about the CAFTA's impact.

[12] Data compiled from U.S. Department of Commerce, U.S. Treasury, and U.S. International Trade Commission.

[13] *Id.*

[14] *World Bank Global Economic Prospects 2005, Trade, Regionalism and Development*, citing Anderson and van Wincoop 2004, Evans 2001, p. 78.

[15] *World Bank Global Economic Prospects 2004, Realizing the Development Promise of the Doha Agenda*, Wilson et al, 2004, "Overview," page xv.

[16] While the ASYCUDA system is widely deployed around the world, it is recognized to be a system in need of modernization. There have been discussions by UNCTAD to privatize the system, which might encourage further developments of its capabilities, but this has yet to occur.

[17] Generally speaking, railroad operations are included in the physical trade infrastructure analysis. In the CAFTA region, however, such services are very limited, with only a handful of dedicated services in discrete areas. Little or no regional activity related to improving the length of haul characteristics is being explored, necessitating reliance on roadway transportation for all goods. Although railroad service has the potential to provide a cost-effective transportation solution over long distances, it is at this time secondary to improving primary transportation systems, *i.e.,* roads.

[18] Throughout this section, composite statistics prepared and promulgated by the World Bank's "Doing Business" initiative are cited as important benchmarks for reform. These statistics represent an enormously important "conversation starter" because they effectively encapsulate how certain economies are less effective than others in growing and sustaining businesses. With respect to the more complex question of *why*, both the individual country reports emerging from the USAID/Booz Allen Trade and Commercial Law Assessment Activity and this regional report strive to illuminate and prioritize the urgency of the issues behind the composites in the CAFTA region – that is, to tell the story behind the story. The World Bank's statistics are not perfect—the portrayal of El Salvador's company registration procedure fails to capture the strengths of that system, for example—but the statistics generally succeed in broad-lining the areas where important reforms must begin.

[19] *See* World Bank, *Doing Business 2004: Understanding Regulation* at xv.

[20] *See, e.g.*, OECD Principles of Corporate Governance (April 1999), located at http://www.oecd.org/daf/governance/principles.htm.

[21] *See* World Press Review, *Interview: Peruvian Economist Hernando de Soto* (October 15, 2003) (http://www.worldpress.org/Americas/1602.cfm).

[22] Center for International Private Enterprise, *An Interview with Hernando de Soto*, Economic Reform Today (1996) (http://www.cipe.org/publications/fs/ert/e19/desoto.htm).

[23] World Bank, Doing Business Database, http://rru.worldbank.org/DoingBusiness (2004).

[24] "Measure First, Then Cut," The Economist (September 9, 2004) (summarizing World Bank, *Doing Business in 2005: Removing Obstacles to Growth* (2004)).

[25] *See* OAS, Department of International Law, Model Inter-American Law on Secured Transactions (http://www.oas.org/dil/CIDIP-VI-securedtransactions_Eng.htm).

[26] Christie S. Warren, Judicial Mentor Program: Handbook for Mentors, at 5 (prepared for Judicial Mentor Program conducted in Haiti).

[27] *Id*.

[28] *See, e.g.*, USAID Office of Democracy and Governance, *Achievements in Building and Maintaining the Rule of Law* (November 2002) at 120 (citing significance of relationships built over time between Russian judiciary and its counterpart organizations, such as the Judicial Conference of the United States and the Russian Council of Judges, the Administrative Office of the U.S. Courts and the Russian Judicial Department, and between judges in Maryland and St. Petersburg and Vermont and Karelia).

[29] *See, e.g.*, Margaret Popkin, *Efforts to Enhance Judicial Independence in Latin America: A Comparative Perspective*, in USAID Office of Democracy and Governance, *Guidance for Promoting Judicial Independence and Impartiality* (Technical Publication Series, January 2002, Rev.Ed.) at 100; *see also* Hammergren, Linn, *15 years of Judicial Reform in Latin America: Where We are and Why We Haven't made More Progress* (1998); Agenda, Regional Conference, "Promoting Judicial Independence and Impartiality," Tegucigalpa, Honduras (April 10-11, 2002) (http://www.ifes.org//rule_of_law/JI_Conferences/Honduras/Honduras%20Agenda%20Day%201&2%20EN.pdf); Agenda, Third Regional Conference of Justice and Development in Latin America and the Caribbean: Principle Trends of the Last Decade and a View to the

Future, July 24-26, 2003 (http://www.iadb.org/sds/doc/SGC-QuitoAgenda8-EN.pdf); *see also,* Keith Henderson and Violaine Authman, A Model Framework for a State of Judiciary Report for the Americas (2003) at 12 (http://www.ifes.org/rule_of_law/Documents/Quito/Quito%20Henderson% 20EN%20final%20paper.pdf), and Agreement entered into by the Three branches of Government before the Honduran People to Strengthen Judicial Independence and Impartiality (April 10, 2002) (http://www.ifes.org/rule_of_law/ Documents/JIC%20Web/JIC%20Web%20Honduras/Honduras%20Signed%20Agreement%20EN.pdf.

[30] On a scale from 1–10, 10 indicating low levels of corruption.

[31] Significantly, in 2004, El Salvador demonstrated noteworthy leadership, when it became one of nine countries to date that has ratified the UN Convention Against Corruption. *See* http://www.unodc.org/unodc/en/crime_signatures_corruption.html.

[32] *See also,* USAID Office of Democracy and Governance, *Guidance for Promoting Judicial Independence and Impartiality* (Technical Publication Series, January 2002, Rev.Ed.); International Foundation for Election Systems, Rule of Law Toolkit (http://www.ifes.org/rule_of_law/ROL_TK.htm).

[33] *See* Maurice Schiff and L. Alan Winters, "Regional Integration and Development," The International Bank for Reconstruction and Development, 2003.

[34] *See* http://www.bizlawreform.com and www.tcb-fastrade.com for the reports.

[35] Numbers for 2003 and 2004 and not official.

[36] http://www.eclac.org/cgi-bin/getProd.asp?xml=/prensa/noticias/comunicados/2/14762/P14762.xml&xsl=/prensa/tpl-i/p6f.xsl&base=/tpl-i/top-bottom.xslt.